REPORT

OF THE

INCOME-TAX INVESTIGATION COMMISSION

LISHED BY THE MANAGER OF PUBLICATIONS, DELHI, INDIA
THE MANAGER, GOVERNMENT OF INDIA PRESS, NEW DELHI, INDIA.
1949

Price Rs. 1-8-0 or 2sh. 3d.

INCOME-TAX INVESTIGATION COMMISSION

CHAIRMAN

Sir Srinivasa Varadachariar, ex-Judge of the Federal Court.

MEMBERS

The Hon'ble Mr Justice G S Rajadhyaksha

Rao Bahadur V. D. Mazumdar.

SECRETARY

Rao Sahib H. S. Ramaswami

CONTENTS

PART I

PART II

To,

The Secretary to the Government of India,
Ministry of Finance (Revenue Division).

The Chairman and Members of the Income-tax Investigation Commission have the honour to submit the following report:—

1. **The Reference.**—The Taxation on Income (Investigation Commission) Act (XXX of 1947) under which the Commission has been constituted requires the Commission—

(a) to investigate and report to the Central Government on all matters relating to taxation on income, with particular reference to the extent to which the existing law relating to and procedure for the assessment and collection of such taxation is adequate to prevent the evasion thereof; and

(b) to investigate any cases referred to it under section 5 and report thereon to the Central Government.

It will be convenient to divide this report into two parts I and II in the order suggested by the terms of reference, the first setting forth our views and comments on the state of the law and its administration, with recommendations for their improvement, where necessary, and the second dealing with the cases referred to us for investigation and report

PART I

SECTION I—THE BACKGROUND

2. **Recent history of Income-tax law in India.**—We may begin with a brief outline of the recent history of income-tax law and its administration in this country, as the same may help to explain the interpretation that we propose to place upon the terms of our reference and to elucidate the purpose of the recommendations we are making. It may also furnish an answer to the plea strongly urged from some quarters for the simplification of the Income-tax law.

3. It is not necessary for our purpose to go much farther back than 1922, when Act XI of 1922 was passed. This enactment is still our basic legislation in respect of income-tax, though numerous and sometimes radical changes have been made in it from time to time and particularly in 1939. When with the first world war increased taxation became necessary, the rates of income-tax were raised and progressive or graduated taxation as well as super-tax were introduced. The increasing weight of taxation led to a demand for more accurate assessments than the earlier law provided for and the law was therefore substantially recast in 1918. Though the Indian law differed in essential features from the English Income-tax law, the latter has none the less exercised its influence on the former. In 1918, Parliament passed a consolidated income-tax law for the United Kingdom and in 1920 a Royal Commission which had been appointed "to enquire into the income-tax of the United Kingdom in all its aspects and to report what alterations of law and practice are necessary" submitted its report. In India, it became necessary not merely further to improve the law in many respects but also to centralise the administration of income-tax. The question of the amendment of the law was accordingly considered by provincial committees and by an All-India Committee in 1921 and on the report of the All-India Committee, Government introduced the Bill which became law as Act XI of 1922.

4. The 1922 enactment recognised the expediency of limiting the Income-tax Act to the provision of machinery and procedure for the assessment of income-tax, leaving rates of taxation to be fixed every year by Finance Acts. It adopted the principle of making the assessment on the income of the "previous year". Wide powers were given to assessing officers to call for returns, documents, etc. The process of making amendments started from the next year. In 1924, the Government of India appointed a Taxation Enquiry Committee (Todhunter Committee) and Chapter IX of its report contained certain recommendations bearing on Income-tax law. In 1935, the Government appointed a Committee (The Ayers Committee) "to make an investigation of the Indian income-tax system in all its aspects and to report upon both the incidence of the tax and the efficiency of its administration." In making its report, this Committee claimed that its recommendations were designed "to secure the fairest possible treatment of the honest tax-payer and at the same time to strengthen the Department in dealing with fraudulent evasion and what is known as legal avoidance." Amendments based on these recommendations were introduced in the legislature in 1938 and they became law in 1939. During the progress of the Bill, however, some of the important proposals became matters of acute controversy and had to be settled by some kind of compromise between the Government and the opposition in the Legislative Assembly.

5. The amendments made in 1939 and subsequently have greatly elaborated the law. The tax is now levied not only on income as ordinarily understood but also on certain capital receipts which have been included in a special definition of "income." Tax at the rate fixed for the year of assessment is

charged on the income of the "previous year." Both income-tax and super-tax are levied according to the slab system. Elaborate provisions have been enacted for the classification and computation of the total income and the taxable income of an assessee and the allowances and deductions which he may claim. Assessees have been divided into several categories, *e.g.*, individuals, undivided Hindu families, firms (registered and unregistered), associations, limited companies and private limited companies and there are special rules applicable to each category. A differentiation had to be made between residents and non-residents and a peculiar category of persons labelled "not ordinarily resident" has been created. The procedure for assessment has been elaborated; and a radical departure was made from the previous law in the creation of machinery dealing with appeals in income-tax matters. Assistant Commissioners have been divided into two groups, one retaining executive functions and the other engaged solely in hearing appeals. Above the Appellate Assistant Commissioners, a new and independent authority known as the Appellate Tribunal has been created. A provision (section 18-A) introduced in 1944 as an anti-inflationary measure requires certain classes of assessees to pay provisionally and in advance the estimated tax due on their income from sources to which section 18 is not applicable; the provisional payment is adjusted when the regular assessment is made.

6. **Recent history of income-tax administration.**—A brief reference to the machinery that has been administering the law is necessary to complete the story (*Note*.—The subject is being more fully dealt with in paras. 358 *et seq*). Before 1922, there were not many wholetime Income-tax officers. Except in a few places income-tax work was largely done by land revenue officers as a subsidiary duty. The non-official members of the All-India Committee of 1921 recorded the following opinion: "A matter of greater importance than the amendment of the Act is an increase in the number and efficiency of the staff which should consist of officers of the highest training and integrity." They strongly recommended that the Income-tax Department should include experts of high standing trained in accountancy whose remuneration should be such as to reflect the market value of their professional experience and talents. Accountancy, they said, should be one of the foundations of training for the whole service. The scale of pay, they added, should be such as to attract the best material available (paragraph 61 of the Report). As already stated the legislation of 1922 effectively centralised the administration of the Department. A Board of Inland Revenue was created—the Central Board of Revenue took its place in 1924—and in due course a regular hierarchy of officials acting under the control and supervision of the Board and the Provincial Commissioners was constituted. The powers and functions of the Commissioners were prescribed with reference to defined local areas. The Todhunter Committee emphasised the necessity for organising a really efficient machinery for the assessment and collection of the tax. Some years later, the Ayers Committee also made its observations on the administrative machinery. During 1938-39, a new temporary circle called the Special Provincial Circle was formed in Bombay to examine important and difficult cases on the lines followed by the enquiry branch in the United Kingdom. The amending Act of 1939 contained a provision empowering the Central Government to appoint not more than three Commissioners to discharge "without reference to area" the duties of a Commissioner in respect of certain classes of cases (meaning special branches for work of special difficulty or importance). Under this provision the Bombay temporary circle was transformed into a Commissionership without reference to area and a number of important cases were assigned to it "with a view to their thorough examination". A central Income-tax Department was constituted in Calcutta in May 1941 "to deal with a selected number of difficult cases requiring detailed and thorough investigation and other cases in which evasion on a considerable scale was discovered or suspected."

About the middle of 1943 it came to the notice of the Board that considerable leakage of revenue was taking place in all Provinces in India owing to the under-assessment of contractors during the war years. This was ascribed chiefly to the fact that there was no machinery in the Income-tax Department for collecting and furnishing to Income-tax officers the necessary "intelligence" in regard to the colossal profits that were being made by contractors in the altogether unprecedented circumstances created by the war. It was therefore decided to set up a Special Branch under the direction and control of the Director of Inspection (Income Tax) to do investigation and collation work in connection with the assessment of contractors in all Provinces. This office had branches in New Delhi, Calcutta, Bombay Lahore and Madras. Information was obtained from (a) the Director General of Supplies, (b) the Food Department, (c) the C.P.W.D., and (d) the Military Engineering Services. Information was later obtained also from the offices of the Textile Commissioner, the Director of Munitions Production, the Controller of Supplies, Bombay and the Director General of Shipbuilding and Repairs. In order to collate the information thus obtained, a Collation Branch was formed in Madras in 1944 and this Branch still continues to work. It gets daily payment sheets from the Controller of Food, Delhi, Director General of Purchases, etc., and all the disbursing officers under the Provincial Governments and quasi Government institutions such as Municipalities: the information is collated there and sent to the Income-tax Officers concerned.

8 A reorganisation of the Department was attempted in 1946-47: it was then decided that each Commissioner of Income-tax should have a Special Investigation Branch attached to his office, *i.e.*, in the Provincial Headquarters cities This Branch was to do all the investigation work required in particular areas Its work was mainly to keep a general index register of the city in question, to do survey work regarding assessees, to co-ordinate information received in the shape of intimation slips or otherwise and to ensure that the information was placed in the relevant files for consideration by the assessing officer. However, as the requisite staff could not be recruited, much of the work which was contemplated to be done by this branch has not yet been undertaken The lack of staff has considerably reduced the effective working of this organisation During 1946, the collation of the returns furnished under section 19-A (in respect of dividends), which was previously done by the Income-tax Officer, Simla, with a special staff under him, was transferred to the Collation Branch in Madras

9 As regards the cadre of Income-tax Officers, who may be said to be the backbone of the service, it would appear that some effort was made to give effect to the recommendations of the 1921 Committee in appointing the required staff The Todhunter Committee recognised that great progress had been made in that direction but added "much remains to be done" They accordingly advised that "for the next few years attention should be concentrated on the task of organising a really efficient machine for the assessment and collection of the tax" (paragraph 229). During the depression of the thirties the cadre of Income-tax Officers seems to have appreciably suffered, particularly in respect of its numerical strength, though in the lower grades there was at one time an addition of a large number of temporary employees who had been entertained to deal with the sudden increase of assessments during the period when the assessable minimum had been reduced to and remained at Rs. 1,000 (1932-34). The Ayers Committee made detailed recommendations for the reorganisation of the Department, the recruitment and training of officers and the improvement of their methods of work.

10. After the legislation of 1939, the need for the improvement of the administrative machinery became even more urgent than before, but there was hardly sufficient time for the recommendations of the Ayers Committee being given effect to, before the conditions created by the war brought about a serious breakdown in the working of the Department. Businessmen and speculators were able to make large profits by legal as well as illegal means; the control regulations led dealers to conceal their most profitable transactions from the knowledge of the authorities; and the steep rates of taxation increased manifold the temptation to evade proper assessment. All the time the Department had not the staff, either numerous enough or sufficiently qualified, to deal with the situation. Successive administration reports have repeated that in spite of prosecutions and the levy of penalties, attempts at evasion had continued and one of the reports recorded, "as old methods of concealment were being detected, new methods were being developed." Commenting on the report for 1943-44, the Public Accounts Committee seems to have remarked that no revenue should be lost on account of shortage of staff and that Government should take all necessary steps to strengthen the Income-tax Department.

11. Towards the end of 1945, the then Director of Inspection (Mr. K. R. K. Menon) was deputed to demarcate in each Commissioner's charge the I.A.C's charges and individual I. T. circles, detailing for each circle the number and grade of I. T. Os. required, the ministerial staff required, etc. It appears from paragraph 27 of his report that arrears of assessment had grown from 1,19,000 at the end of 1943-44 to 1,81,000 and odd at the end of 1944 45 and he expected them to go to nearly 2,27,000 at the end of 1945-46. Assessments for the year 1946-47 were estimated at about 5,55,000. The D. I. recorded it as his definite opinion that "practically all our offices are wholly under-staffed.........Our arrear position is very unsatisfactory at the moment and unless the quality and number of the various grades are increased, it will be impossible for us to get out of the morass within a reasonably short period."

12 The reorganization proposals submitted by the D. I were, with some modifications, given effect to in August 1946 as regards Income-tax officers and some time later as regards the ministerial staff. The scheme has not even yet come into full operation, because the number of additional officers required according to it cannot be obtained without long delay involved both in recruiting them and afterwards training them. A staff that requires highly specialized skill cannot be increased in a hurry. It will be some years before one can judge of the practical operation of the new scheme. One thing seems to be clear, that the position as regards arrears and the consequent increase in the number of pending proceedings has definitely deteriorated.

13. When sanctioning the reorganization scheme, the Secretariat seems to have expected that by the end of the financial year 1947-48, the arrears ought to be round about the normal figure of 1,00,000 which is a manageable figure for disposal in the period between the close of the year and the time the next assessment comes in. Far from this expectation being realised, the accompanying statement kindly furnished to the Commission by the Central

Board of Revenue gives an idea of the position as it stood on 31st July 1948 :—

1. No. of arrear assessments pending on 31-7-1948.	2,86,274 made up of		
	1947-48	..	1,54,344
	1946-47	..	77,121
	1945-46	..	36,923
	1944-45	..	17,527
	1943-44 & earlier.	..	359
2. No. of Refund applications pending on 31-7-1948	21,204 (which includes 2,118 of 1946-47, 1,086 of 1945-46 and 695 of 1944-45 and earlier.)		

SECTION II—SCOPE OF THE REFERENCE

14. We now proceed to determine the scope of the reference to the Commission, in the light of the above facts and circumstances. The general words in section 3 of the statute, *viz.*, "to investigate and report to the Central Government on all matters relating to taxation on income" are words of very wide import. The words following, *viz.*, "with particular reference to the extent to which the existing law relating to and procedure for assessment and collection of such taxation is adequate to prevent the evasion thereof" have the effect of laying stress on certain aspects of the law relating to the assessment and collection of income-tax. The preamble recites that the purpose of the appointment of the Commission was to ascertain "whether the actual incidence of taxation on income is and has been in recent years in accordance with the provisions of law and the extent to which the existing law and procedure for the assessment and recovery of such taxation is adequate to prevent the evasion thereof". In the light of these expressions, various suggestions have been made to us as to the proper scope of the Commission's duty. Some have advocated a very restricted view; others have gone the length of suggesting that we must recommend a wholesale revision of the law and the enactment of new legislation based on more equitable principles than the present; yet others have pleaded for a simplification of the law. We doubt if it was the intention of the legislature that this Commission should consider the possibility of a wholesale revision and re-enactment of the law relating to income-tax. We also doubt whether such a wholesale revision is now necessary or possible. We are not on the other hand inclined to put an unduly restricted interpretation on the words quoted above and limit the scope of the Commission's recommendations to the problem of evasion or avoidance. We do not, however, wish to ignore the fact that a large-scale revision was made in 1939 and many of the provisions then introduced have not yet had a fair or ~~long~~ enough trial in normal circumstances. Recent changes in the political set-up and in the economic environment of the country and developments which are likely to take place in the near future seem to us, nevertheless, to justify and even necessitate a reconsidedation of certain questions in the light of the experience of the last ten years.

15. It has been strongly pressed on us that the present rates of income-tax and super-tax are so high as to defeat their purpose by discouraging enterprise and by increasing the temptation to conceal business income It has been added that there is more likelihood of a larger tax income being realised

at a moderate rate of tax than at a higher rate. We do not belittle the force of this argument, but we do not feel that such questions of general financial policy are within the province of this Commission. The rates of taxation are expected to be fixed in the Finance Acts of each year on a due consideration of the then financial needs of the State and the revenue that such rates are expected to bring. So far as the temptation to evade is attributable to high rates of taxation, it must be met in the same manner as every other attempt to evade tax.

16. It has next been urged that if our income-tax system attempts to follow in many respects the main lines of incom-tax law obtaining in other civilized countries, it must also adopt such of the features in those systems as favour the assessee. Particular reference has in this connexion been made to the system of allowances and deductions for members and dependants of the family granted by the English income-tax law. We have every sympathy with this argument. The Indian tax law no doubt exempts a certain limit of income from tax. But there is no denying the fact that this exemption does not properly give effect to the principle of relating the tax to the taxpayer's "ability to pay". The exemption under the Indian law has no relation to the needs and circumstances of each individual assessee. A bachelor and a married man, a man with a large family and a man with no family, are alike granted the exemption. A logical application of the principle of "ability to pay" will certainly require something like the allowances system of the English law related to the domestic responsibilities of each tax-payer. But we must recognize that in the peculiar constitutional situation obtaining in India today, it is not easy to give effect to this proposal. If the ability of the assessee is to be properly determined, his whole income, whether agricultural or non-agricultural, will have to be taken into account. But the Indian constitution takes agricultural income out of the sphere of central taxation. Whether it may not be possible to take even agricultural income into account for the purpose of determining the "ability" of the assessee, though not for the purpose of levying a central tax on such income, is another question. The Ayers Committee recommended that agricultural income might be taken into account for the purpose of determining the rate at which the tax on the other income of the assessee should be computed; even this has not been given effect to There may be some practical and administrative difficulties in doing this satisfactorily today. If and when agricultural income-tax becomes a regular part of provincial finance, some system may be devised by which both categories of income can be brought under a single machinery of assessment and recovery, though the proceeds may afterwards be shared between the centre and the provinces. It should then become possible to introduce an appropriate system of deductions per head for members of the family, dependent relatives, etc.

17. Turning next to the plea for the simplification of the law, it is no wonder, in the light of the story set out above, that the income-tax law is felt to have become much too complicated. Even a British Chancellor of the Exchequer (Dr Dalton) is reported to have stated some years ago that the income-tax law (which he described as "cumbrous and elephantine") stood in need of simplification and clarification. Simplicity and clearness are no doubt very desirable in taxing statutes; the truth, however, is that successive attempts to make the tax more productive have brought in their train new problems. High rates of tax have necessitated the introduction of alleviations in the interests of various classes of taxpayers, whether to mitigate opposition or with the intention of making the system more scientific or in response to outcries against excessive burdens. To increasing ingenuity shown by the taxpayer in devising methods of avoidance, the legislature has had to respond with provisions designed to stop loopholes and make evasion difficult. The British

Codification Committee was asked to draft a Bill with the special aim of making the law as intelligible to the taxpayer as the nature of the legislation admitted. It produced a draft with 417 sections and the report stated that "simplification of law in the sense in which the ordinary taxpayer understands the system was not practicable. A statute which professes to cover a vast field including at one end the simple finances of the salaried clerk and at the other end the complicated intricacies and ramifications of great banks, insurance companies, international finance houses and commercial and industrial combines cannot avoid being as comprehensive and as complicated as the subject-matter with which it deals." In India, the subject was further complicated by certain special features of its political set-up, economic life, etc., *e.g.* the existence of the Indian States with their own systems of taxation, the joint family system, the existence of foreigners making money in India without being domiciled or even resident here, etc. It was urged that the law, as it is, made it impossible for ordinary businessmen to prepare their own returns and drove them to seek the help of advisers or so-called experts who often advised them into attempts at evasion. We are not in a position to say how far this assumption is true. To the extent to which it is true, the situation can be met by instructing officers and senior clerks of the Department to help assessees. We understand that even now there are instructions to that effect issued to the staff, but they have to guard against the danger of assessees afterwards turning round and alleging that they put in particular entries in their returns because they were advised so to do by the members of the staff.

18. It remains to add a few observations relevant to the problem of avoidance and evasion. According to well-established usage, the term "avoidance" denotes the utilization of loopholes to effect tax savings, within the letter though perhaps contrary to the spirit of the law. It is rendered possible by defects in the framing of the law or in its drafting, as a result of which cases within the intendment of the law have not been brought in by clear or apt words or cases which ought to be fairly comprised within the policy of the law have been omitted by oversight or for other reasons. Leakage of tax in this way has to be prevented by making the law clearer or wider; but there will never be an end to attempts at income-tax avoidance. Though a Lord Chancellor some years ago referred in terms of disapprobation to the efforts of tax dodgers and "to the professional gentlemen who assisted in the matter" (*Latilla vs. Inland Revenue Commissioners*—Law Reports 1943 Appeal Cases at page 381) popular or professional opinion does not seem to share that view but is prepared to regard such attempts as a "commendable exercise of ingenuity". As courts are slow to construe tax laws according to their "intent" (as distinguished from the letter of the law) occasional modifications of the statute will be necessary to close loopholes that "judicial construction cannot plug". "Evasion" is applied to the escape from taxation, accomplished by breaking the letter of the law, whether intentionally or through mistake or negligence. Most frequently, taxes are evaded because proper administrative machinery has not been provided or the machinery is not working properly. Evasion has therefore to be combated mainly by "improving" the administration of the law—we advisedly say "improving" though some would prefer to speak of it as "tightening" the administration. To the extent to which the weaknesses of the administration may be traceable to defects in the law (particularly in the sanctions provided by the law) some changes in the law may be necessary even to prevent evasion. Under a system where the assessment of the tax depends to a large extent upon information given by the assessee, he has every opportunity and when the rate of tax is high every temptation to attempt evasion. This can be met only by improving the efficiency of the administration.

19. Both the tax-dodger and the innocent taxpayer complain of "official inquisition" and harassment by the officers of the Income-tax Department.

It is therefore necessary not only to increase the 'efficiency' of the Department but also to improve its relations with the public. A writer on "Public finance", even while recognising that nobody can be expected to be enthusiastic about tax payment, adds that a certain grudging co-operation on the part of most taxpayers is necessary for the effective administration of any taxing statute. He advises "Special efforts on the part of the administration can arrest much of the popular prejudice: bureaucratic indifference of the tax administrator is the most common cause of inconvenience to the taxpayer." The Royal Commission appointed in England in 1920 to deal with income-tax law similarly recommended that the tax gatherer must strive to reduce the odium of the levy and increase the willingness or at any rate to reduce the unwillingness with which the assessee pays his tax. Care must be taken, they said, not to harass or irritate the general run of taxpayers, merely because it is necessary to deal severely with the tax-dodger. The general taxpayers' goodwill is essential if the Income-tax administration is to produce its best effects. It must, however, equally be recognised that it is not easy for the taxpayer to enter into the psychology of the Inspector of Taxes, nor is it easy for the revenue official to appreciate the effect of high taxation upon the taxpayer who is dependent "on the elusive thing called profits". Nevertheless, they must attempt to understand each other.

20. As regards the conditions obtaining in this country, the Ayers Committee (1937) observed "The fairly general complaint that the I. T. Os. do not show enough consideration for the convenience of the assessee is certainly not without foundation". In another place, when dealing with refunds, the Committee stated "The general attitude of officers of the Department to refund claims leaves much to be desired". As late as 1943, the Chief Justice of the Bombay High Court made strong remarks about the way in which the rights of appeal provided by the law (as it then stood) to the Assistant Commissioner and the Commissioner "proved a farce" in practice. Apparently because of the radical change resulting from the introduction of the Appellate Tribunal, the officers of the Department complain that their work has been made very difficult by the way that the tribunal deals with matters coming before it, while we gather that the tribunal often finds itself embarrassed by the attitude of the officers of the Department in their very method of approach to the problems that arise before them. This does not surprise us. It is the result of the history of the English Constitution that in their anxiety to protect the individual from the tyranny of the taxing power, courts were tempted to act on the principle that the taxpayer was the injured man and the taxing agency the wrong-doer. Without presuming to express or even pausing to form any opinion as to the right or wrong of the situation, we content ourselves with an earnest expression of our desire and hope that every endeavour may be made to improve the relations between the public and the officers of the Department.

21. In making our recommendations, we shall proceed on the footing that there is likely to be no immediate radical change in the economic structure or the basis and purpose of the taxation system as it exists today. In the light of the considerations above set forth, we have come to the conclusion that we shall best fulfil the intent of the statute creating the Commission by considering not only the problems connected with avoidance or evasion of income-tax but also questions which either by reason of omission or uncertainty or imperfection in the existing law or of the new set-up of our environment seem to require attention. Our recommendations are directed not merely to changes in the law but also to the creation of a changed outlook in the administration with a view to secure the maximum of efficiency as well as smoothness of working.

SECTION III—PRELIMINARY STEPS

22. Soon after the Commission entered on its duty, our attention was called to the way in which section 34 of the Indian Income-tax Act had been

interpreted and applied by Courts and Tribunals since 1939, when certain amendments were made to that section. This is one of the principal provisions in the Act calculated to check evasion, as it empowers Income-tax officers to assess or re-assess escaped income. With a view to prevent serious loss to the revenue from the way in which this section was being interpreted, we felt that certain amendments should be urgently made. We accordingly prepared a memorandum explaining the changes which, in our opinion, were needed. Copies of this memorandum were circulated to Bar Associations and commercial bodies in the country and in the light of suggestions and representations received in response thereto, we drafted certain amendments and submitted the same to Government on 28th February 1948 with an explanatory memorandum (Appendix A). A Bill embodying these amendments was introduced into the legislature during the budget session and after it was reported on by a Select Committee, it was passed by the legislature during the autumn session.

23. During May, we prepared a questionnaire (Appendix B) containing 60 questions and distributed copies thereof to a large number of persons, associations and institutions who may be presumed to be interested in the subject. Replies thereto were received in the course of July, August and September. Our grateful thanks are due to the individuals and bodies who have so kindly favoured us with their considered views and with helpful criticism and advice. We take this opportunity of correcting an erroneous assumption which we find made in some of these replies. The questionnaire has been criticised as "drafted with the soul object of making the provisions of the Income-tax law very stringent" and from the way that the questions were worded they were assumed to reflect the *views* of the Commission. It was even remarked that the "Commission seems to be dominated by one objective, *via.*, collection of more revenue and by the departmental view-point". As will be seen from the covering letter that accompanied the questionnaire, the Commission had to recognise the fact that they were "principally concerned with topics of legal avoidance, evasion and the causes which lead to the tax not being levied or collected through defective machinery of the Department". But the questionnaire was not limited to these topics. It was not fair to the Commission to insinuate that even while framing the questionnaire it had already formed views on the questions contained therein. The questionnaire included many questions which had been noted for consideration from time to time by the Income-tax Department and the Department naturally formulated the questions in terms which carried an implication as to the view which it would prefer. In other instances, points of view had to be clearly indicated in the very frame of the question, only with a view to invite replies directed to those points of view. With these preliminary observations, we proceed to deal with the various topics covered by the questionnaire though not quite in the order in which they have been set out there.

24. Referring to certain information that the Commission had asked for from Banks and to the fact that we had restricted the requisition to transactions of "persons other than Europeans and Anglo Indians", a contributor to "Indian Finance" has expressed his regret that a body whom he is good enough to credit with "integrity and fairness" should have made such an "invidious distinction". He attributes this to a weakness which must have infected the Commission from its prevalence (according to him) in the Income-tax Department, *viz.*, a belief "that Indians were dishonest while the Europeans were honest". We can only express in turn our regret that the writer could not have thought of any other explanation. The reason for so limiting the information called for from the Banks was that none of the cases referred to the Commission for investigation related to Europeans or Anglo-Indians and as the Banks were complaining of the amount of time and labour

involved in complying with the requisitions sent by the Commission, we desired to minimise the extent of our demand by excluding transactions of certain categories of persons who did not come within the purview of our investigation. As we knew that many transactions had been placed in fictitious names or in the names of relatives and dependants of the real parties, we could not limit our requisition by specifying the names of the parties about whom we required information.

SECTION IV—RECOMMENDATIONS.

A.—Residents and Non-residents.

(Questions 1, 2, 3, 4, 6, 13, 17, 33 and 38).

25. Though income-tax is levied on income, many of the elements bearing on its assessment depend on the status or circumstances of the person whose income is sought to be charged. Questions 1, 2, 6, 13, 17 and 33 of the questionnaire envisage modifications in the taxation of certain categories of persons. To elucidate the reasons for our proposals in this behalf, it may be convenient to re-state certain fundamentals. This is also necessary to lead up to and explain the proposals that we make in respect of such of the residents of the acceding Indian States as do business or have business connections in the Indian Union.

26. The theory of *economic allegiance* (as distinguished from *political allegiance*) has now been generally accepted as the basis of taxation. But the complexities of modern life and business compel a variety of refinements and adjustments in the practical application of the theory. An individual has economic interests in the place of his residence as well as in the place of the origin of the whole or part of his income. Looking at the matter from another point of view, the tax that a man is called upon to pay to the State may be said to be divisible into two parts, *viz.*, that which is due for the protection and maintenance of particular sources of income and that which is due for the privileges which the citizen himself enjoys in his person and residence. Attempts to define the basis of taxability have accordingly to take note of this dual nature of a man's allegiance or of the benefit derived by him from the State. The rule of the English Income-tax law (as to taxability) accordingly was "either that from which the taxable income is derived must be situate in the United Kingdom or the person whose income is to be taxed must be resident there". Dealing with the general principle relating to the taxability of foreign income, the Privy Council in a recent appeal from India (Wallace Bros' case (1948) 2 M.L.J. 62 observed: "The resulting general conception as to the scope of the income-tax is that given a sufficient territorial connection between the person sought to be charged and the country seeking to tax him, income-tax may properly extend to that person in respect of his foreign income." How in certain circumstances the "origin of income" may itself become an important factor in determining "residence"—especially in the case of corporations--will appear from the following observation in the same case:—"The derivation from British India of the major part of its income for a year gives to a company as respects that year a territorial connection sufficient to justify the company being treated as at home in British India for all purposes relating to taxation on its income for that year from whatever source that income may be derived."

27. After *taxability* has been established, three matters have to be considered before the tax to be charged can be determined, *viz.*, the amount of income to be assessed, the rate of taxation and chargeability to super-tax. The amount of taxable income is determined, sometimes on the *accrual* basis, *i.e.*, with reference to the place of its origin, sometimes on the *remittance* basis, *i.e.*, the place where it is received or brouhgt, though it might have original elsewhere, and sometimes both bases are combined. In determining the rate

of taxation and the liability to super-tax, the theory of "ability to pay" also comes into play. It has been claimed that the principle that a person should contribute to the revenue of the State in proportion to his ability would justify the inclusion (in his taxation) of income derived by him from abroad, even apart from its remittance to this country, because that income has also to be taken into account as an index of his ability. But, so far as a non-resident is concerned, opinion amongst economists seems to be divided as to how far foreign income can legitimately be taken into account even as a factor bearing upon the assessee's ability to pay and the rate at which he is to be taxed (including chargeability to super-tax). Some consider it fair enough to treat a non-resident on the same footing as a resident for this purpose. It must, however, be remembered that a non-resident is not treated on the same footing as a resident in respect of several kinds of allowances and deductions. The taxation of non-residents is beset with difficulties not only in the matter of realizing the tax but of ascertaining with any approach to accuracy the 'foreign' income of the non-resident. There is also some force in the argument based on the practical difficulty of applying the principle of progressive taxation to foreigners as they may be receiving several sums of income (large or small) from different countries. This is the difficulty referred to in question 3 of the Questionnaire.

28. It is recognised that in the framing of the Income-tax law, consideration has to be given not merely to the revenue aspect but also to the possible economic effects of any course proposed to be adopted. For instance, in the case of residents, if external income is excluded from taxation, it may tend to encourage the investment abroad of capital which may otherwise be employed within the country and to its advantage. On the other hand, in the case of non-residents, the imposition of a tax even on income derived within the country may effect the investment of foreign capital within the country and if their foreign income also is to be taken into account (either as being assessable or at least as an element in determining the rate at which their internal income is to be taxed), it is *a fortiori* bound to affect the flow of foreign capital into the country. It is thus clear that questions like these have to be considered with due regard to the economic position of the country, according as it is a debtor country or a creditor country, an importing country or an exporting country, and according as it stands or does not stand in need of foreign capital and the help of foreign businessmen.

29. Till recently, moneys were invested in India by foreigners—generally British people—not at the behest of the people of India but as a result of the foreigner's desire to find profitable investment for his capital. Every encouragement to such investment was given by the British Indian Government of the day. Indian opinion would have gladly seen that such investors at least paid a fair tax on their Indian income to the Indian Exchequer. But as this did not always happen, the opposition took every opportunity to press for its being done. The position has now changed. If Indian opinion and the Indian Government desire to invite foreign capital and foreign business, liability to tax is an important factor for the foreign investor to consider before deciding whether he would invest money in India or not. Even if in form the tax liability is imposed on him, the terms of his investment may be such as substantially to shift the incidence of the tax to Indian shoulders.

30. The existence of the Indian States has greatly added to the difficulties of administering the Indian Income-tax law. In legal theory, the Indian States have hitherto been regarded as foreign States; but their geographical situation makes it both anomalous and inconvenient to treat the citizens of these States as non-residents or foreigners. The economic life of the two Indias is inextricably bound together: many people who do a large volume of business in India have their homes or some kind of headquarters in the

Indian States. It may be broadly stated that the money which the States' subjects have been earning in British India is many times more than what the British Indian subjects were making in the States. As a matter of policy relating to double tax relief, an amendment introduced in 1941 exempted from Indian taxation, income, profits or gains accruing or arising in an Indian State unless such income, profits or gains are received or deemed to be received in or are brought into British India in the previous year by or on behalf of the assessee or are assessable under section 42. This provision has frequently been taken unfair advantage of by making it appear that income which really accrued from business done in India resulted from business done in the States. Other ways in which the proximity of the States has served tax-dodgers will be pointed out when we deal with the cases which have been referred to the Commission for investigation.

31. We feel that a radical change is both necessary and justified in the treatment by the Indian Income-tax law of persons residing in the Indian States. Without attempting to anticipate the details of the constitutional set-up that may come into existence and the financial arrangements that may come in its wake, we would suggest that arrangements, legal or political, should be made so as to bring into the category of "residents" for the purposes of Indian Income-tax law, at least such of the residents of the Indian States as have business connections or sources of income in the Indian Union. If the terms of the accession of any State or of the financial arrangement with it (for purpose of defence) are such as to make the Indian Income-tax Act applicable *proprio vigore* to the people of the State, the only question of practical importance will be as to the administering agency. Divided authority in the matter of assessment is calculated to help evasion. So far, at any rate, as concerns the assessment of persons who derive taxable income from *both* Union territory and State territory and of Indian residents deriving taxable income from State territory, it must be arranged that the assessment may be made by officers of the Indian Income-tax Department, subject to any arrangement between the Union and the State as to the division of the proceeds of the tax. Even if the rate of tax adopted by any particular State should be different from the Indian Union rate, that need cause no serious difficulty. Once the assessable income has been properly determined, it would be quite easy to calculate the tax respectively payable on the portion which would be subject to the State rate and the portion subject to the Union rate. The assessing officer should be able to exercise the same powers in the State as he has in the Indian Union, for collecting information relevent to the assessment and enjoy all the other facilities required to make those powers effective. As regards other categories of "non-residents", it may be necessary to consider in due course the justification for or propriety of continuing the discrimination now made in favour of "British subjects" and the appropriate manner of dealing with residents of French and Portuguese possessions in India and of Pakistan, Burma and Ceylon who may have sources of income in India.

32. Broadly speaking, the position in India prior to 1939 was that income-tax was levied primarily on the basis of the principles of *origin* and *receipt* of the income Income was taxable if actually or according to certain presumptions it arose, accrued or was received in British India. Domicile played no part in determining tax liability. The residence of the tax-payer was taken into account in certain provisions under which income was deemed to arise or accrue or to be received in British India. An enterprise conducted by a resident tax-payer was taxable on all income arising, accruing or received for the first time in British India and also on profits arising or accruing abroad if they were brought into British India within three years, but other foreign income was not taxable as a general rule. An enterprise conducted by a non-resident was taxable on income arising, accruing or received for the first time in British India.

33. The legislation of 1939 substituted the basis of *accrual* of income (in place of the *remittance* basis) in respect of the foreign income of one resident in British India; this necessitated a more precise definition of "residence". It was contended on behalf of a certain group that persons who came to British India for business or employment and had their "residence" here but whose permanent home was outside British India should not be taxed on their foreign income on the "accrual" basis. The Ayers Committee did not accept this contention and they were of the opinion that justice would be done to all interests if residence was defined on the lines suggested by the British Codification Committee, subject to a few modifications. Though they definitely rejected the suggestion to modify the accrual basis by qualifications as to domicile—because that would amount in practice to discrimination in favour of Europeans and residents domiciled in an Indian State—the Government of the day in the amending Bill which they brought in introduced that qualification. The Select Committee (majority) left this provision substantially as it was, but by a new clause which has been since enacted with certain modifications as sections 4-A and 4-B of the Act, they inserted certain definitions of "residence" and "domicile". Many members of the Select Committee were not prepared to agree to these provisions; when the matter came before the legislature, the points at issue were settled by a compromise between the Government, the opposition and the European interestes. The reference to domicile was omitted and cases of alleged hardship were attempted to be met by the creation of a special category of persons described as "not ordinarily resident" defined as follows:—

> "An individual is 'not ordinarily resident' in British India in any year if he has not been resident in British India in nine out of the ten years preceding that year or if he has not during the seven years preceding that year been in British India for a period or for periods amounting in all to more than two years." (section 4-B).

This category of persons, though resident in the ordinary sense pays tax only on the income which accrues in India *plus* the amount of foreign income which they may bring into British India. It would also seem that even in respect of this income they pay tax not at the rate applicable to their world income but at the rate appropriate to the assessable income. They would thus be better off than both "residents" and "non-residents". Question 1 in the Questionnaire relates to the necessity or expediency of retaining this category. It must be noted that this category is not the mere negative of "ordinarily resident". There is indeed no definition in the Act of the expression "ordinarily resident" In this respect, the legislature has not chosen to follow clause 6(2) of the British Codification Committee's draft which (preferring to use the expression "principally resident" for "ordinarily resident") runs as follows.—

"An individual who in a year of charge is resident in the United Kingdom but is not a resident solely therein—

(a) shall be treated as being principally resident in the United Kingdom if in the year of charge—

(i) he maintains or has maintained for him a dwelling place or a place of business in the United Kingdom but neither a dwelling place nor a place of business elsewhere, or

(ii) he neither maintains nor has maintained for him a dwelling place or a place of business in any country but is domiciled in the United Kingdom;

(b) shall in a case to which paragraph (a) does not apply be treated as being principally resident in the United Kingdom if he appears in view of all the

circumstances of his case to be so resident having regard in particular to his domicile, nationality and habits of life "

The Indian Act contains no corresponding provision.

34. Once residence is made the main factor in the assessment of income-tax, difference has to be made between mere casual or temporary residence, longer residence and habitual residence as judged by tests of duration or intention. The relative liabilities of the three categories proposed by the British Codification Committee were thus formulated by them:—

> "If the individual trader is principally resident in this country, we propose that he shall be liable on the whole of the profits of his business wherever carried on, if not so principally resident, he is to be liable on the whole of the profits of such part only of his business as is carried on in the United Kingdom though if resident but not principally resident he will also be liable on such of the profits of the business carried on abroad as he brings to the United Kingdom."

The three categories according to the Indian Act are "resident", "non-resident" and "not ordinarily resident". In defining "resident" in section 4-A, the Indian legislature has adopted sub-clauses (a), (b) and (d) of clause 6 (1) of the British Codification Committee's draft but not sub-clause (c).

35 As regards companies, the opposition in the 1939 Legislature insisted that in view of the conditions under which foreign companies carried on business in this country (with their central control generally abroad), companies though incorporated abroad and managed from abroad should be treated as *resident* companies for the purpose of the Act if they earned their profits out of operations substantially carried on in British India To give effect to this claim, section 4-A (c) was enacted. Here again, the legislation did not follow the language of clause 7 of the British Codification Committee's draft. Question 6 of the Questionnaire brings out certain points of practical disadvantage in the operation of section 4-A (c) as it stands, though its sponsors assumed that it would secure to the Indian revenue what they felt was justly due to it. The assessment is on the total income of the "previous year" and the residence of the assessee has to be determined with reference to such year The foreign income of the assessee which is subjected to assessment is what accrued or arose to him outside British India during such year. According to the second part of section 4-A (c), a company will be resident in British India in any year only if its income arising in British India in that year exceeds its income arising outside British India in that year The residential qualification of the assessee may change from year to year. In the case of a foreign company doing business both in India and abroad, its status as a "resident" in a particular year (determined according to the above definition) while it imposes certain liabilities, also confers certain privileges on it Chief among these privileges is the right to set off losses abroad in calculating the assessable income If in any year the company in question made a profit in British India but sustained losses in its business abroad, the result might be to make it a resident company for that year and accordingly the assessable income would be the British Indian income *minus* the foreign loss. It might even happen that the foreign loss exceeded the profit made in British India so that not merely would there be nothing to tax but there might be a balance of loss to be carried forward This would be nothing to complain of if the British Indian exchequer could have the benefit of the good years also just as it might have to take notice of the loss in the bad years, taking the company's world business as a whole But the moment the company's foreign business brings good profit, its status *vis-a-vis* British India may change into that of a "non-resident" as the foreign income may exceed the British Indian income. The result will be that the Indian Government can

no longer claim to tax its foreign income. There are today no special provisions calculated to meet this feature characteristic of the non-Indian business of companies which by virtue of section 4-A (c) may become alternately resident and non-resident. There is also the fact that assessing officers do not always find it easy to get full and correct information from such companies as to the profits made or losses incurred abroad. We may now proceed to answer the questions falling in this group.

36. *Question* 1.—Explaining the need for the creation of the category of persons described as "not ordinarily resident", the Member in charge of the 1938 Bill stated that while he recognized that all who lived and worked in India should be liable to taxation on equal terms, two classes of persons had to be specially dealt with: (1) the European official or the trader in the early years of his stay in India, before it had become established that his career was in India, and (2) the Indian trader abroad who had an ancestral home in India which he might visit irregularly but possibly enough to become technically resident every year. He added that the Muslim League was particular about the second category. Whatever might have then been the need or justification for special treatment of these groups, it seems to us no longer necessary or right to continue to recognize them as special cases. Under the conditions existing today, the class of officers who mainly constituted the first group has ceased to exist. As regards the rest of the two groups, it is difficult to understand why their residence in India should have been minimised in importance by calling it *technical* residence. No one is going to be taxed on the ground merely of casual or occasional residence. The tests prescribed in section 4-A are in many cases sufficient to exclude hardship; and if any still remain, they may be dealt with by appropriate changes in section 4-A (a) (ii). It is not easy for the income-tax authorities to determine on the kind of evidence that will be available after the lapse of seven years how many days a person has been present in India during that period. Most of the replies to our Questionnaire agree that this special category of "not ordinarily resident" may be omitted. We recommend accordingly.

37. *Question* 2.—The fact that the law has defined "residence" (and by implication "non-residence") with reference to each year gives rise to various problems. One of the results of this definition is that an individual may be resident in British India in a year or even for a number of years, then become "legally" non-resident for a year or two and then again become "resident." These changes have a material bearing on the nature and extent of his liability to Indian income-tax, though in substance and according to the sense of the ordinary man there might have been no change in his status all the time. As pointed out in Question 2, a non-resident is not liable to pay tax on foreign profits even if they are brought into or remitted to British India during the particular year in which he is able to claim the status of a non-resident. This makes a certain extent of manipulation possible. The abolition above recommended of the category of "not ordinarily resident" may increase the temptation for such manipulation. Of the two groups of persons for whom that category was meant, some may find it possible so to time their visits as not to become resident in any year. They would thereby be avoiding even the liability now existing, *e.g.*, tax on the profits of a foreign business controlled in India. They could also arrange to remit their foreign income to India in a year in which they had contrived to fall into the non-resident category or in the year in which they have suffered a loss in India or to visit India in a year in which there is a loss abroad to be set off against Indian income.

38. One of the suggestions made in Question 2 as possibly calculated to obviate consequences of the above kind is the introduction of a positively defined category of persons "ordinarily resident" similar to that of persons "principally resident" in the British Codification Committee's draft; but the

liability which that draft imposes on the "resident" as distinguished from the "principally resident" is not the same as the liability which the Indian law imposes on the resident. (See the extract quoted in paragraph 34 *supra*). The British classification will not fit in with the scheme of the Indian law. Its adoption, especially as it brings the conception of domicile into the definition of "residence," may in some measure have the effect of wiping out the results of the omission of the category of "not ordinarily resident." There are indeed some who prefer to qualify the application of the theory of "residence" by reference to the principle of "nationality" or "domicil"; this may offer a reasonable provision applicable to persons who are "domiciled" but *temporarily* non-resident. But once that principle is introduced, we shall have to provide for a multitude of possible combinations of the tests of "residence" and "non-residence," domicil and alien, accrual and remittance, total income and total world income, etc. Whether any distinction corresponding to that suggested by the British Codification Committee between "residents" and "principally residents" could and should be adopted in this country can be safely determined only after some experience has been gained of the operation of the law without the category of "not ordinarily resident".

39. The alternative solution suggested in Question 2 is whether even non-residents should be declared assessable to tax in respect of profits brought into or remitted to British India. While some of the replies to our Questionnaire seem prepared to go the length of supporting the suggestion in unqualified terms, the weight of opinion is in favour of the view that remittances of profits to India by *bona fide* non residents cannot justly be subjected to tax nor will it be expedient to tax them. We are in agreement with this view. But the question arises, can the expression "bona fide non-resident" be applied to a person who has been resident in previous years and becomes resident again in future but happened to be a non-resident only for an intervening period during which he managed to remit his foreign earnings to British India. A suggestion has been made that foreign profits remitted to British India by a non-resident should be declared taxable if he established residence here within a defined period from the year in which the remittance was made; but such a provision can easily be circumvented. It is indeed difficult to devise a formula which is incapable of being circumvented. On the other hand, any provision on the lines suggested or even similar thereto will cause great hardship in a class of cases which may assume importance in the near future in view of the conditions developing in South Africa, Malaya, Burma and Ceylon. Indians who have long been residents there may find themselves compelled to come over to India and start business here. It will be neither fair nor expedient to put difficulties in the way of their remitting or bringing to India what profits or savings they might have made abroad during the years when they stayed abroad Though we have raised Question No 2, we are not satisfied that the loss to the revenue on account of the possibilities contemplated in that question are so far very large. We do not, therefore, think it worthwhile recommending any change in the law to meet the class of cases contemplated by the question. On the other hand, the abolition of the special provisions relating to persons 'not ordinarily resident" may have the effect of imposing a tax liability on some categories of Indians now living abroad in respect of their foreign savings which they may bring with them when they come over to India for good, because some of them may fall within the terms of section 4 (1)(b)(iii). Appropriate provision must be made to exempt such cases

40 *Question* 3 --This question really covers three classes of cases—

(i) ascertainment of a non-resident's foreign income for the purpose of determining the rate at which his Indian income is to be taxed;

(ii) in cases falling under section 4-A (c), ascertainment of the company's foreign income, with a view to determining whether in any particular year, it is to be treated as resident or non-resident;

(iii) where a non-resident is taxable in respect of businesses or business connections through more than one person in different parts of India, the ascertainment of his total Indian income for the purpose of determining the rate at which he is to be taxed as well as his liability to super-tax.

As regards sub-head (i) [and to a large extent, this applies also to sub-head (ii)], the only suggestion made in the replies is that the assessing officer can call for a certificate or other official record showing the amount at which the assessee's income has been assessed in the country of his residence. It is difficult to see what more is practicable. An alternative which has been suggested in many replies involves a change of policy as regards the taxation of non-resident's income. The point seems to us of sufficient importance to make this suggestion worth considering. It has been suggested that it will be both fair and convenient if in taxing non-residents in respect of their Indian income, their foreign income is not taken into account at all but the rate appropriate to their Indian income with a surcharge of 20 or 25 per cent is adopted. Such a system prevails in some countries and is calculated to save trouble to the assessing officer. But its fairness is open to question. The proposal must also be considered in the light of the arguments as to policy set out in paragraphs 28 & 29 *supra* with reference to the attraction of foreign capital into this country. A modification of the proposal would perhaps meet the argument as to fairness. Instead of adopting the surcharge above suggested as the only method, the non-resident may if he thinks that even the inclusion of his foreign income will not attract as high a rate be given the option of proving his foreign income to the satisfaction of the assessing officer and thus get his Indian income taxed at the appropriate rate. This will shift the burden of proof from the assessing officer to the assessee. It will, however, be anomalous to permit the assessee to change his option every year. He must be in a position to know generally and as a long-term arrangement which of the two courses will be fairer to him, and having once exercised his option, he should not be at liberty to claim the other method. Whether even this proposal will meet the argument of expediency, whether the foreign investor will care to submit to this trouble of proving his foreign income, is a matter that time and experience alone can definitely show. So far as foreign capital needed for the country may be obtained through the intervention of the State, the situation may have to be met by making special provision for taxation on the returns on capital so obtained.

As regards sub-head (ii), the Income-tax Department expects that the recent amendment to the definition of "company" may place the Department in a position of some vantage, because it will make it a condition of declaration of a foreign company "to be a company for the purpose of the Act" that it should agree to give all information that it might be required to furnish. Here again, time alone can show how far this expectation can be realised. A few more observations on this point may be made when we deal with question 6. The third of the sub-heads above noted may conveniently be considered when dealing with Question 4. A similar problem may arise when a non-resident is in receipt of interest or dividends from different banks or companies in different parts of India.

41. *Question* 4.—Question 4 raises a limited point, mainly procedural, in respect of cases where a non-resident has business or business connections in different parts of India through more than one person. There will be obvious advantage in enacting a provision enabling Income-tax authorities to treat one

of such representatives in India as the assessee under sections 42 and 43 in respect of the profits made by or through all the representatives in India. The procedure must, of course be so contrived as not to put the selected representative at any disadvantage. It was accordingly recognised that provision must also be made for retainer of the necessary funds by the representative so selected.

42. The replies have raised wider issues, with reference to the manner in which sections 42 and 43 are applied in practice. One complaint is that section 42 is too broadly worded and, by ignoring the distinction between trading *in* the country and trading *with* the country, is often held to cover cases not within the true scope and spirit of the section. The answer to this complaint is that the very nature of the situation dealt with and the devices resorted to with a view to escape from taxation require a provision in very wide terms to meet the situation. There may be all shades of differences in the authority or instructions given by the non-resident trader to the local businessman selling his goods. Whether a tax liability will arise or not will depend upon and must be determined with reference to the circumstances of each case. The following observations of Earl Loreburn in *Drummond* vs. *Collins*—1915 A.C. 1011 at p. 1017 must be borne in mind in this connection:—

"The Income-tax Acts are framed in very general terms. It is necessary so to frame Acts of this kind lest some case manifestly within the purview of the legislature may escape tax. But Courts of Law have cut down or even contradicted the nature of the legislation when on a full view of the Act considering its scheme and its machinery and the manifest purpose of it they have thought that a particular case or class of cases was not intended to fall within the taxing clause." (See also *Astor vs. Perry*—1935 A.C. at p 417.) We may add that it is not unlikely that in the course of the next few years the methods of non-residents selling their goods in India may undergo changes. We do not, therefore, think it necessary to recommend any change to meet the general complaint about section 42. On the other hand, we are elsewhere (paragraph 134) suggesting that a statutory obligation should be cast on every person doing business for a non-resident to give information about it to the Income-tax authorities.

43. It has next been complained that sub-section (3) of section 42 is quite general in its terms and is applicable equally to foreign goods sold in India and to Indian goods sold abroad but it is in practice applied by the Department only to the second case. The Department maintains that on foreign goods sold in India, the *whole* profit or gain accrues or arises at the place of sale and the whole amount therefore becomes taxable under the general language of section 4 (1). This limited construction of section 42 (3) is supported by more than one decision of the High Courts. It must, however, be said that the Ayers Committee on whose recommendation the sub-section was inserted have made it quite clear (in Chapter I, Section 2 of their report) that they intended the same principle to be applied to both classes of cases. Sections 38 and 39 of the Australian Income-tax Act recognise this principle and in applying it draw a distinction between goods sold in Australia by a foreign manufacturer and goods sold by a person not being the manufacturer. This distinction was based on the recommendation of the Australian Royal Commission on Taxation (1932-33) Paragraph 427 of the Commission's report states—

"The profit derived by a non-resident trader from a business carried on by him in Australia shall be deemed to be—

(a) in the case of a manufacturer—the difference between the amount for which the goods are sold in Australia and the amount for which

they could be sold to a wholesale buyer in similar circumstances in the country of manufacture—less any expenses incurred in transporting the goods to and selling them in Australia, or

(b) in the case of a merchant who is not the manufacturer of the goods sold, the difference between the amount for which the goods are sold in Australia and their purchase price, less the cost of transporting the goods to and selling the goods in Australia."

On the view taken by the Indian High Courts, the taxable profit of the non-resident trader in a case corresponding to category (a) *supra* was stated to be "the difference between the gross costs to the seller of the goods at the moment and at the point of sale and the net price which he receives" (*Hira Mills Ltd., Cawnpore* vs. *Income-tax Officer, Cawnpore*—1946 I.T.R. at p. 424). The learned Judges further explained themselves by saying that the Indian law does not allow "any apportionment of that profit as between the period prior to the moment of export from Gwalior (the foreign territory) and the moment subsequent to that export". We do not pause to consider whether the relevant sections may not bear a different interpretation. Obviously the interpretation placed on the law by the Indian High Courts is different from what the Ayers Committee intended but at no stage during the passage of the Bill was there any indication of an intention to depart from their recommendation. We have been told that the state of import trade in this country is such that the adoption of the view recommended by the Ayers Committee will seriously prejudice the revenue. We nevertheless consider that the matter should be directly presented to the Legislature for examination. If after all the imported goods are *necessary*, the foreign manufacturer can shift the burden of the tax to the Indian consumer. What is in form a direct tax will thus become an indirect tax. The Australian Commission recognised the possibility of practical difficulties arising in the application of the principles stated in its report as the non-resident trader may not always produce his accounts before the assessing officer. They accordingly recommended that if accounts showing the actual profit on the transactions are not produced, the profit should be assessed at a percentage on the amount of the sales, to be determined in accordance with the profits that will be made by a resident trader selling similar goods under similar conditions. Incidentally, we may point out here that if our suggestion to abolish the category of persons "not ordinarily resident" is accepted, the reference to that category in section 42 (2) must be deleted.

44. Proceeding now to the point raised by question 4, we may first state the position in this respect under the law as it now stands. Sections 42 and 43 do not in terms refer to a plurality of representatives of the non-resident trader. The application of the general rule of construction that words in the singular may also include the plural will not be of assistance in this case, because the application of that principle will necessitate the recognition of a plurality of representatives where such exist and will not authorise the selection of one out of many such. Executive instructions issued by the Central Board of Revenue seem to assume that where there are several agents in India, the Income-tax authorities may treat one of them as the representative of the non-resident, not merely for the business that he is in charge of but even in respect of the businesses conducted in other parts of India through other agents. It is, however, not clear whether and how far these instructions were based on the assumption that one of these agencies was in the nature of a head office with a certain measure of control over the rest. In Mr. Sundaram's Commentary on the Income-tax Act, there is a note under section 43 to the following effect:—

"If a non-resident has more agents than one, there is nothing to prevent the Income-tax Officer from serving notices on all the agents and finally selecting one among them and assessing him on the combind income of the principal through all the agents together."

G10909

In such cases, naturally the Income-tax Officer will select the most important of the agents. Referring to the observations of Rowlatt J. in *Commissioners of Inland Revenue v. Longford; Commissioners of Inland Revenue v. Pakenham and others*—13 Tax Cases 573—that "An agent cannot be taxed on profits not made through his agency", Mr. Sundaram observes that section 43 of the Indian Act is much wider. Mr. Sampath Ayyangar, however, takes a different view. He concludes that there is nothing to warrant the view that a person could be treated as an agent in respect of incomes with which he is totally unconnected or in respect of activities of the non-resident with which he has no concern. He supports this view by reference to the right of retainer provided for by the second proviso to section 42 (i) which *prima facie* can relate only to a person who has some control over or receipt of the particular income. In the judgment of the Privy Council in *Commissioner of Income-tax, Bombay vs. Currimbhoy Ibrahim & Sons*—1935 I.T.R. 305—there is a passing observation at page 402 stressing the fact that the respondents were sought to be assessed as agents in respect of property "with which they had no concern". The law is thus far from clear or certain and it seems to us both necessary and desirable to clarify it by specific enactment. A proper method of assessment requires that the income derived by the non-resident trader from his different businesses in different parts of the country and through different persons should be aggregated for purposes of assessment and where recovery from the non-resident himself may not be easy some provision must be made for recovery of the full assessment from one responsible resident representative instead of its being recovered piecemeal from the assets lying in or profits made in different parts of the country

45. While some of the replies have approved of the proposal, many have laid great stress upon the heavy, if not impossible, burden which such a course must impose upon the person selected as the sole representative. Any such selection must, of course, be made only after notice to the non-resident trader wherever possible and after notice to the person proposed to be selected as the sole representative and after hearing their objections, if any. It has been asked, what is the representative thus selected to do, to obtain information about (i) the principal's foreign income, where that is relevant, and (ii) the principal's Indian income earned through other business connections. If the non-resident trader is prepared to be helpful to the authorities, there can be no difficulty in his helping the representative and in his instructing his several representatives in India to enable the selected representative to give all material information to the Department, to enable them to make a proper assessment. If he is non-co-operative, it is all the more reason why the Income-tax authorities should have a power of the kind proposed. If the business in each locality is to be assessed by the officer having jurisdiction in that locality, the Department may not even have full and accurate information as to all the different business connections of the non-resident trader and the assessment cannot be correct or complete. We are, therefore, of the opinion that power should be conferred upon Income-tax authorities in clear terms to make such a selection. A provision similar to section 219 of the Australian Income-tax Act would serve this purpose.

46. There is, however, force in the objection about the personal liability of the selected representative and the retainer of funds by him because he cannot be expected to have control over the business conducted elsewhere by other representatives. The personal liability of the representative assessee as well as his right of retainer must be limited on the lines indicated in provisos two and three to section 42 (1). For the recovery of the balance of the tax, there is the power under the first proviso to that sub-section and the best that can be done is to authorise the Department to freeze the assets in the hands of the other representatives till the assessed tax is paid up.

47. *Question* 33.—As question 33 arises out of section 43, it may also be conveniently dealt with here. At the instance of the Select Committee that considered the amending Bill of 1938, Government introduced the first proviso to section 43, so as to exclude the imposition of a "statutory" agency under that section on an Indian broker dealing with a foreign broker acting for on undisclosed foreign principal. As pointed out by Mr. Sampath Ayyangar, the resident broker may not even know the principle. The question is now raised with reference to the possibility that the person on the other side may not be really acting as a broker, but may merely be an *alias* for the non-resident trader. The replies point out and we agree that this must be dealt with like any other question of fact and cannot be met by any change in the law. The Income-tax Officer may examine the correspondence between the parties, make enquiries from Brokers' Associations here and abroad and pursue any other clue that the circumstances of each case may furnish. Even if the assessing officer is misled on this point, there need not necessarily be a loss of revenue the non-resident principal, if only he could be reached, will be liable, provided the conditions of section 42 are satisfied. One or two of the replies have suggested that the first proviso to section 43 may be omitted. We do not think it will be right to do so, as it may place the Indian merchant in a very difficult position—an embarrassing situation from which the Select Committee purposely attempted to save him.

48. *Question* 6.—The considerations that underlie this question have been explained in paragraph 35 *supra*. Some of the replies think that there is no serious danger of the existing law under section 4-A (c) proving detrimental to the Indian revenue. We do not feel so sure as to this. Some of the replies merely point out that it will not be fair to tax the foreign income of a company but refuse to take its foreign losses into account The question has not made any such suggestion. As already explained, the situation envisaged in the question arises because under the peculiar terms of the provision in section 4-A (c), the Indian Exchequer cannot tax the foreign income during the years in which it exceeds the Indian income of the company Some of the replies have suggested that (for the reasons discussed in para. 40 *supra* about non-residents generally) it is best to leave out of account both the foreign losses and the foreign income of a company not controlled from India. This is to lose sight of the conditions and ways in which foreign companies do business in India. At any rate, Indian opinion has strenuously fought for the provision made in section 4-A (c) and we are not at present prepared to recommend a radical change in this respect. An alternative suggestion has been made which seems to us both reasonable and practicable. It is to the following effect:—The company shall be allowed to set off foreign losses against Indian income only on condition that it agrees to bring into the account of Indian taxation at least a like sum out of its foreign income in the years in which its status may become non-resident by reason of its foreign income being greater than its Indian income. The question whether in any particular year it has made more than 50 per cent of its income in India must be decided independently of the foreign losses brought forward from the previous year. If the company desires to avail itself of the benefit of accumulated losses for six years, it must agree to bring into account its world income even if in the subsequent years it has become non-resident. Alternatively, it may be provided that foreign losses can be set off only against foreign profits.

49. *Question* 13.—Question 13 mainly relates to one of the problems arising out of the theory that even the foreign income of a non-resident is relevant to his Indian assessment for two purposes: (1) the determination of the rate at which his Indian income is to be assessed; and (2) the determination of his liability to super-tax on his Indian income. Provision for deduction of super-tax in respect of dividends paid to non-residents has been made in sub-sections

(3-D) and (3-E) of section 18; but these provisions come into operation only when the Income-tax Officer has knowledge that the non-resident's total world income exceeds the super-tax minimum or the dividend payable by any one company to a shareholder exceeds that minimum. As we have already explained when discussing question 3, the authorities in India have great difficulty in ascertaining the foreign income of non-residents and sometimes even in realizing the tax due from them. Further, sub-section (3-E) of section 18 will not apply to cases where only the *aggregate* of dividends received from more than one company exceeds the super-tax minimum.

50. The proposal suggested by the question, *viz.*, to ask the Indian companies to deduct super-tax from dividends payable to all non-resident shareholders, even when the amount of dividend is below the maximum of the amount not chargeable to super-tax, is apparently expected to save trouble to the Department; but we do not think that in the long run, it will really save trouble even to the Department, because there must inevitably be a large number of applications for refund, resulting from such a procedure or there will be applications for exemption from numerous shareholders, on the ground that their income is below the minimum. There will of course be this advantage to the revenue, that the initiative and the onus will be thrown on the non-resident; but such a course will involve hardship to many of the non-resident assessees by compelling them to make refund applications. Further, it may not always be easy for a company to know whether a person to whom it is paying a dividend is a resident or a non-resident especially where the dividend is collected by a bank on behalf of the shareholder or on behalf of a number of shareholders. There is also the general question of the policy as to the treatment to be meted out to the non-resident investors to which we have already adverted. We are not, therefore, prepared to recommend the adoption of the course suggested in the question.

51. Some of the replies have made a suggestion which may be tried for what it is worth, especially as we are recommending the creation of some kind of central organization. The suggestion is that all companies should make a return to a central organization in respect of dividends paid to non resident shareholders. The central organization should determine the total dividend and issue instructions to the various companies to deduct super-tax at appropriate rates. This procedure may to some extent help action under section 18 (3-D); but even this will not give the officer the total "world" income in cases in which that is relevant to the action to be taken under section 18 (3-D). If the experiment is to be tried, it may be worth considering whether such central organization should not be asked to deal with all matters relating to the taxation of non-residents and not merely with their dividend income. We may add that the problem which this question seeks to tackle may not arise at all if the course which we have elsewhere discussed (para 40 *supra*) of taxing the Indian income of non-residents at a surcharge over the Indian rate (without reference to their foreign income) is adopted.

52. *Question* 17.—Section 14 (2) (c) and proviso (1) to section 24 (1) are inter-related provisions inserted in 1941; logically, they must have the same scope. Proviso 1 to section 24 (1) is, however, not happily worded; it must be recast so as to make its scope and intention clear. Further, the very circumstance of its being enacted as a *proviso* and not as an independent provision has been relied on by the Bombay High Court (in Muralidhar Mathurawalla's case)—1948 I.T.R. 146—for restricting its operation to cases which would otherwise have fallen within the main provision of sub-section (1) of section 24. This defeats the purpose of the sponsors of the proviso. The idea in enacting this provision obviously was that when a British Indian assessee sustained losses in an Indian State, such losses should not be taken into account so as to reduce the taxable amount of profits made in British India during the same period, though such losses (equally with profits made in the States) may

be relevant to the determination of the "total world income" for the purpose of fixing the *rate* of tax. This is made clear by the observations of the Select Committee in relation to that clause, but the provision was unfortunately inserted in a wrong place and in a wrong form. The Bombay High Court cannot be blamed for feeling itself bound to apply a well-established rule of statutory construction that a proviso can only be interpreted as a restriction on or exception to the operation of the main enacting clause to which the proviso is attached.

53. Elsewhere (paragraph 31 *supra*) we have suggested that residents of the States quite as much as residents of the Indian Union should be assessed by the same authority, so far at any rate as both have sources of income in both areas. *A fortiori* should the Indian authorities have power to assess Indian residents in respect of income derived by them in State territory. If these suggestions are given effect to, it may no longer be necessary to have provisions like those found in section 14 (2) (c), proviso (1) to section 24 (1) and proviso (a) to section 24 (2). So long, however, as the existing policy and arrangement continue, it will be better to have the language of proviso 1 to section 24 (1) improved and it is necessary to have it enacted as an independent substantive provision. The language of proviso (a) to sub-section (2) of section 24 is also capable of similar improvement, particularly if proviso (1) to sub-section (1) is going to be recast and inserted elsewhere. It does not appear convenient or appropriate to introduce these provisions into section 10 merely because the Bombay judgment is based on section 10. It seems best to treat the three provisions section 14 (2) (c), proviso (1) to section 24 (1) and proviso (a) to section 24 (2) as one group of allied provisions relating to a special category described as "Income and losses in the Indian States" and enact them as three sub-sections of an independent section, say section 24-C. As a precaution, the section may begin with the words "Notwithstanding anything contained in the other provisions of this Act". When recasting the provisions opportunity may also be taken to clarify one or two points raised by Mr. Sampath Ayyangar in his Commentaries on this provision. A query suggested by him in this connection, *viz.*, whether the amount of foreign losses or profits should in any case in which they are relevant to British Indian taxation be fixed in accordance with the result of the assessment, if any, made in the foreign State, or could they and should they be re-estimated by the Indian authorities is a question relevant not merely to these provisos, but to all cases where foreign gains or losses have to be taken note of in the course of British Indian assessment.

54. *Question* 38.—This question has been raised at the instance of the Department which feels that there has been considerable loss of revenue during the war years, on account of assessees and would-be-assessees leaving India for good without paying the tax due from them and without leaving any assets behind. A very limited provision to meet this contingency has been made in section 24-A, but the utilization of this provision depends upon the Income-tax Officer *chancing* to get information as to the movements of the assessee. No obligation has been imposed on the assessee to inform the Income-tax authorities about his intended departure and none has power to prevent him from going away without paying the tax. The Australian Act contains drastic provisions in this behalf.

They are as follows:—

"210. Upon the application of any person about to leave Australia, the Commissioner, Second Commissioner or a Deputy Commissioner may issue a certificate—

(a) that that person is not liable to pay income tax; or

(b) that arrangements have been made to the satisfaction of the Commissioner for the payment of all income tax that is or may become payable by that person.

211. (1) Unless and until such certificate has been presented to the office of the owner or charterer, or of the representative of the owner or charterer, of the ship or aircraft by which that person intends to leave Australia at the port or place at which his passage is to be booked, an authority for that person to travel by that ship or aircraft shall not be issued by the owner or charterer or a representative or employee of the owner or charterer.

(2) Any person who, in contravention of this section, issues an authority to any person to travel by the ship or aircraft shall be personally liable to pay the amount of tax, if any, which is or may become due and payable by such person, and shall be guilty of an offence.

Penalty; Not less than Fifty pounds or more than Two hundred pounds.

212. (1) The owner or charterer, or the representative of the owner or charterer, of every ship or aircraft which takes passengers on board at any port or place shall, on the first working day after the departure of the ship or aircraft from that port or place, lodge all certificates so presented at the office of the Deputy Commissioner of Taxation for the State in which that port or place is situated, together with a list showing the name and last-known address in Australia of every person (other than members of the crew and staff of the ship or aircraft) who travelled on the ship or aircraft.

(2) Every owner or charterer, or his representative who fails to comply with this section shall be guilty of an offence.

Penalty: Not less than Ten pounds or more than One hundred pounds."

Section 213 which is also a useful provision enacts:—

"213. (1) Where the Commissioner has reason to believe that any person establishing or carrying on business in Australia intends to carry on that business for a limited period only, or where the Commissioner for any other reason thinks it proper so to do, he may at any time and from time to time require that person to give security by bond or deposit or otherwise to the satisfaction of the Commissioner for the due return of, and payment of income tax on, the income derived by that person.

(2) A person who fails to give security when required to do so under this section shall be guilty of an offence.

Penalty: Not less than Two pounds or more than One hundred pounds."

55. A point for consideration is whether in future, foreigners are likely to do any large volume of business in this country under conditions which would make it necessary or expedient to enact provisions so drastic as those found in the Australian Act. The proximity and situation of Pakistan (and perhaps even Ceylon) may easily help a person, if he is so minded, to elude such provisions. One thing, however, is obvious *viz* that section 24-A is wholly insufficient to meet the case. Save in exceptional circumstances, an obligation must be cast by law on the person, intending to leave this country to give to the Income-tax authorities reasonably sufficient notice of his intention so to leave and if the tax payable up to the date of departure is not assessed and paid before departure, the Income-tax Officer must have power to demand security for payment. It will follow that there must be some provision prescribing the consequences of the assessee's default either in giving information of his intended departure or in giving security for payment of the tax that may be found to be due. An obligation must also be cast on the Income-

tax Department to complete the assessment as expeditiously as possible in such cases. In enacting provisions on the lines suggested above, care must be taken so to word them that they will not cover tourists or casual visitors.

56. Some of the replies have suggested that a provision may be enacted to the effect that no passport shall be issued except on production of a certificate from the Income-tax authorities similar to the one required under the recent Transfer of Property (India) Ordinance before registration of a document of transfer. But, if, as we are given to understand, a long interval may elapse between the issue of a passport and its actual use, such a provision will not cover taxes that may fall due during the interval. It may be worthwhile considering whether a provision similar to that contained in the recent Transfer of Property (India) Ordinance should not be enacted as a permanent law of the land. Such a provision may not, however, be of much use if it is limited to transfers of *immovable* property; but a provision covering businesses and moveable and intangible assets will be dangerously wide and difficult to enforce.

57. Even the enactment of provisions on the lines suggested in the preceding paragraphs will not obviate the need for the Income-tax authorities being constantly on the look-out as to remittances sent abroad of profits made in India. To this end, we commend the suggestion made by an experienced officer of the Department that special officers appointed for the purpose must collect information from the Exchange Banks and other Banks as to remittances to foreign countries and scrutinise them to see which of them are remittances in the ordinary course of trade and which are remittances of profits.

58. Before we leave section 24-A, we may make a few observations on the language of the proviso to sub-section (1) of that section, in view of its criticism by Mr. Sampath Ayyangar. The obvious intention of the proviso is that the language of the main sub-section should not authorise a back-assessment in excess of what is permitted by section 34. But the language of the sub-section was not wide enough to cover all the cases which must have been contemplated As it stood prior to 1939, it merely referred to the last previous assessment as the starting point for the emergency assessment under section 24-A But what is to happen if there had been no previous assessment at all? An amendment was introduced in 1939 to include such a case. But what about cases where there had been a previous assessment but it was defective for various reasons? That the "previous assessment" contemplated was a "full assessment" is made clear by the use of the words "fully assessed" in another part of the sub-section even as it stood before 1939. But as pointed out by Mr. Sampath Ayyangar these words did not appear in the proper place. This defect may be rectified by inserting the word "fully" between the words "last previous year of which the income has been" and "assessed in his hands" in sub-section (1). The words "fully assessed" should be repeated in the place where they are now found in the second sentence of the sub-section.

B.—The Hindu Undivided Family.

(Question 5).

59. Several questions have been raised and many suggestions have been made with reference to the method of assessing Hindu undivided families to income-tax. They may be grouped under two heads: (a) fairness and justice in the assessment of H.U.F. and (b) the operation of the exemption allowed by section 14 (1).

60. The Hindu undivided family has long been regarded for income-tax purposes as a single unit, being represented by its manager. It is now well settled that this rule is applicable both to families governed by the Mitakshara

school of Hindu Law and to families governed by the Dayabagha Law. Before discussing the appropriateness of the method in vogue now and examining the various suggestions made for its modification, it may be convenient to clarify at the outset whether and how far the difference between the two main schools of Hindu Law call for or justify any difference in the treatment of the two classes of cases. Under the Dayabagha Law, the father is the absolute owner even of the property that has devolved on him from his father and of its income. None of the sons can interfere with the father's title to or control over the family property or his enjoyment of its income. Accordingly, in a Dayabagha family, though the father and the sons may be spoken of as a "family", there is no legal significance in describing such a family as an "undivided" family. The appropriate method of assessment in such a case is to assess the father as an individual in respect of the income coming into his hands, whether it be from inherited property or from his self-acquired property.

61. Under the Mitakshara Law, the father is in respect of the joint property of the family only in the position of a manager (the Privy Council have even spoken of him as a trustee in a general sense) on behalf of the family including himself. The sons have a right by birth in the family property; they can restrain the father from alienating it except for certain purposes and they can demand a partition of the family property at any time even when the father is alive. The inroads effected on this theory by the doctrine of the son's liability for the father's debts have no bearing on and need not be allowed to complicate the present discussion. There is thus an obvious distinction between the character in which the father in a Dayabagha family receives the income of the property under his control and that in which the father in a Mitakshara family receives the income of the family property. Looking at the matter, however, from the point of view of the several members of the family, the position in the Mitakshara family as regards the *income* from the family property is that as long as the family is undivided, no individual member can be said to be absolutely entitled to the income or to *any part thereof*. If at all, such absolute ownership can be predicated only in the family and ownership of or control over the income is what matters for purposes of income-tax.

62. The death of the father leaving sons brings about a radical change in the position under the Dayabagha Law, but very little change in the position under the Mitakshara Law. Under the latter, the only change that takes place is that the eldest son will become the manager of the family in place of the father. Under the Dayabagha Law, on the other hand, the absolute ownership of the father gives place to the common ownership of the sons and an "undivided family" comes into existence. Between brothers owning inherited property under the Dayabagha Law and brothers owning family property under the Mitakshara Law, there is this difference, *viz.*, that even before partition, the Dayabagha brothers hold defined shares in severalty whereas the Mitakshara brothers hold their interest in coparcenary and cannot even predicate the precise quantum of their respective shares except as associated with a partition at any particular moment of time. So far, however, as the right *to the income* is concerned, there is little difference between the Mitakshara family and the Dayabagha family, when they consist of brothers. In both cases, as long as the family continues undivided, the family manager receives the income and even a Dayabagha sharer, though his share in the corpus is defined, is not entitled to a corresponding or any specific share of the income so as to enable him to call for an account from the manager as to how he spent that part of the income of the family properties or indeed any part of the family income, so long as it is applied for the common purposes of the family. In

this sense, there is no individual ownership of any specific share of the family income, under either law, by any of the members as long as the family remains undivided.

63. Under the Hindu Law, the right to maintenance is of two kinds: one based on more relationship, e.g., the obligation of the husband to maintain his wife or of the father to maintain his minor children, whether he has property or not, and the other based on possession by one person of property out of which another has the right to be maintained. In the latter case, the expenses of maintenance are in a broad sense a charge on the income accruing from the property. But the right to maintenance is not unless fixed by agreement or by decree of court a right to a specific amount or to a specific share out of the family income nor a specific charge on the family property. What is important at this stage to note is that in respect of the *income*, there is little difference—in the nature of the right though there may be a difference as to quantum—between the right of the undivided sharers and the right of the maintenance holders. Acting on this view, section 14 (1) treats all payments to members of Hindu undivided families on the same footing, whether they be payments made to males or to females, to sharers or to maintenance holders. And when the family income has been assessed as a whole, it logically follows that no portion of it can be re-assessed in the hands of the members among whom it is distributed.

64. The above discussion must serve to show that the assessment of the undivided family as a unit not only is not inconsistent with but substantially agrees with the legal position under the Hindu law. There is, however, no denying the fact that this method of assessment has long been complained against as harsh or unfair. This feeling rests on two considerations: (i) a consciousness that in substance, if not in theory, the income of the family property is the income of those entitled to shares in that property; and (ii) the undoubted right of any sharer—at any rate of every adult sharer—to become divided at his or her choice and thereupon to take separate possession of his or her share. Those who defend the existing law contend that the very fact of the sharer not exercising that option to become divided proves that he or she has something to gain by continuing undivided and they therefore see nothing wrong in his or her being asked to take its legal consequences. But those who believe that the joint family system—so far as it has withstood even the individualistic tendencies of our time—has still a useful role to play in Hindu social life naturally regret that the Income-tax law should add a powerful stimulus to the disruptive forces already in operation. This school of thought has put forward the broad claim that the H.U.F. should be assessed on the same lines as a "registered firm" consisting of all the sharers or at least of the adult male sharers, though the tax so determined may be recovered from the managing member who will be in possession of the whole income from the family properties. The Ayers Committee made some observations on the *pros* and *cons* of this argument: they even concluded that 'there is some case for the recognition of the special position of the H.U.F." but they were worried about "the effect on the revenue of any concession" in this respect. They ended by recommending a "practicable concession" but even this has not been conceded by the Government. It is, therefore, no wonder that the claim for special treatment has been revived.

65. We do not think that it is for us to take considerations of revenue into account in making a recommendation if we are satisfied that a particular course is required or justified by law or principle. But, as we have already explained, the position of brothers even in an undivided Hindu family does not correspond to that of partners because the latter are entitled to specific shares in the partnership income and are entitled to an account in respect of the same. The position in the Mitakshara family is further complicated by the existence of the

right by birth so that one must take into account not merely sharers of the same grade of relationship but all male descendants in the different branches. The number of sharers may vary even from month to month by reason of births and deaths.

66. While the analogy of a partnership is for the above reasons untenable, there is great force in the argument of hardship and there is much to be said in favour of the view that the H.U.F. may be treated as a special category by itself instead of being assimilated to an ordinary individual. We have every sympathy with the argument that persons who would otherwise be prepared to continue undivided should not be driven to seek division with a view to escape or minimise taxation. Apart from the love of the orthodox or the conservative section of the population for the joint family system, it possesses economic advantages which have some value even today. It deserves at least as much encouragement as any co-operative endeavour and it helps in many cases to prevent an otherwise inevitable fragmentation of land. Sir C. P. Ramaswami Ayyar has stated that in the agricultural income-tax legislation of Travancore, it has been provided that those who consolidate their holdings will get some concession but those who partition their lands must pay tax at progressively higher rates. Though our Income-tax law is not concerned with agricultural income, the principle underlying the above differentiation deserves to be borne in mind in dealing with the claim made on behalf of the undivided family.

67. In the replies to our Questionnaire, various suggestions have also been made as to the concessions which may reasonably be made to a Hindu undivided family without radically altering the present method of assessment. One of them is that deductions at certain rates analogous to the allowances permitted under the English law to children and dependent members should be allowed in proportion to the number of (i) members in the family, or (ii) the adult sharers, or (iii) at least the married adult sharers. Rightly or wrongly, the Indian Income-tax system has not adopted the English model in this respect and it will be difficult to fit this proposal into the existing scheme of the Indian assessment. Further, as pointed out in paragraph 16 *supra*, the system of allowances cannot be satisfactorily operated unless agricultural income also is included in the taxation scheme.

68 The most feasible method of granting relief seems to us to be to raise the limit of the non-taxable maximum, both in respect of income-tax and of super-tax As will be seen from the decisions which we shall presently refer to [when discussing section 14 (1)], the family will be a unit of assessment only when there are at least two *shares*—under what circumstances women can be regarded as "sharers" for this purpose need not be discussed here. The minimum concession would, therefore, be that when an undivided family is assessed as a unit, the non-taxable maximum both in respect of income-tax and super-tax should be at least twice that prescribed for individual assessments This apparently is the principle underlying the raising of the exemption in respect of insurance premia to 12,000 which is double the amount of the exemption limit prescribed for individuals; the former practice of fixing a minimum of Rs. 75,000 for liability to super-tax in the case of joint families rested on a similar principle. But we do not see why the application of the principle should stop there and should not be extended to income-tax and super-tax liability as well.

69. Some of the replies have suggested that the non-taxable maximum for income-tax and super-tax should be raised *in proportion* to the number of sharers or at least the number of branches. This will in many cases practically assimilate the result to "individual" assessment of the several sharers and as we are not prepared to recommend the latter course, we do not think it right to reach much the same result indirectly. We cannot, however, deny that

there is some force in the argument based on the number of shares. We would therefore recommend one further step, *viz.*, that where the undivided *branches* are four or more than four, the non-taxable maximum (for both income-tax and super-tax) should be thrice that fixed for individual assessment. We have advisedly said *branches* and not shares: our intention is to have regard only to the main branches and not to the descendants or sub-sharers in each branch—to the *stripes* and not to the *capita*. We do not, however, think it necessary to go on making the same increase in respect of the exemption for insurance premia. If members of the family wish to take out insurance policies for larger amounts, there is nothing to prevent their doing so for their individual benefit and paying the premia out of their separate income which is subject to separate assessment.

70. The concession recommended by the Ayers Committee was limited by them to cases where there were more than one *adult married male* member. We see no justification in principle for restricting the concession by the three words which we have underlined. In Dayabhaga families and even in Mitakshara families (as a result of the Hindu Women's Right to Property Act) women may become "sharers" in the family property: why should such cases be excluded? Again, the married man may become a widower; should the method of assessment change immediately? If, not why should there be a difference between a widower and a bachelor, so long as nothing is made to turn on the existence of children? We see even less justification for the further condition they attached, *viz*, "that the individual income of all members (including wives and minor children) from whatever source derived" should be included in the income of the joint family for purposes of taxation. This looks very much like punishing the members of the joint family for daring to ask for concessions. The wives may have their stridhanam properties, the minor sons may have property inherited from the maternal side. They are certainly entitled to be separately assessed in respect of their income. Why should they be called upon to pay tax or tax at a higher rate or even super-tax in respect of such income, by clubbing it with the income of the family?

71. In view of the above recommendation, we do not think it necessary to discuss the suggestion that the graduation of the tax may be lower in the case of Hindu undivided family. We have already had complaints that there are too many rates and we do not wish to add to the complexity of the tax schedule. We are unable to entertain the suggestion that every adult male member of the family should be given abatement similar to earned income relief. The assessable income of the family may not in whole or in part be earned income and even if it be, it cannot be presumed that every adult male member has laboured to earn it It will be no easy task for the Income-tax Officer to determine which of the members are contributing by their labours to the taxable income of the family and what is the extent or value of each member's contribution. There is some justification for the suggestion that each working member of the family should be allotted a salary and that such salary should be assessed as his individual income and treated as an item of allowable business expenditure in the family account. Apart from such *notional* allotment of salary—which will be very difficult to work in practice—it is not uncommon in trading families, especially where they have businesses in different places, to put some members in charge of particular businesses and pay special remuneration to them. If the analogy of a "company" should be followed (because the family is like the company treated as a legal entity), such salary will resemble salary paid by a company to a Director or employee who is also a shareholder. But there is more in common between a partnership and a family business than between a company and family business; and as long as salary paid to a partner is not treated as an allowable deduction under the head of Business expenditure, there is little justification for meeting out a different treatment to special remuneration paid to a member of an Hindu undivided family for looking after the family business. We may, however, point out that in ***Commissioner of Income-tax, Bihar and Orissa* vs. *Jainarain Jagannath*—1945 I. T. R. 410—a**

Division Bench of the Patna High Court held that in the absence of a specific statutory extension of section 10(4)(b) to joint families, the disability therein enacted in respect of partners should not be extended to members of joint families. In this view, they expressed their conclusion in the following words: "The amount paid can be legitimately deducted if it is found to be a *bona fide* payment to a *bona fide* employee for services actually rendered and is not excessive or unreasonable and is not a device to escape income-tax". The qualifications by which the proposition has been hedged round in the above quotation show the difficulty of the task thereby set to the Income-tax Officer. The recognition of a right of deduction in such cases will tend to encourage fraud and attempts at evasion by fixing alleged remuneration at arbitrary rates to several members of the family. The considerations which led the Legislature to supersede the previous case-law relating to partners by the enactment of section 10 (4) (b) are, in our opinion, equally applicable to remuneration claimed by a member of a joint family for looking after the business of the family. We would advise legislation on the lines of section 10 (4)(b) even in respect of joint family members except so far as interest on self-acquired or separate funds lent to the family may be concerned.

72. In view of the discussion in paragraph 62 *supra*, it is not necessary to deal at length with the complaint against the insistence (in section 25-A) upon a division by *metes and bounds* before "family" assessment can give place to individual assessment of the sharers. So far as the section applies to Dayabhaga families, it can only speak of a division by *metes and bounds* because the sharers already hold their shares in severalty. So far as families governed by the Mitakshara law are concerned, a mere division in status will only place them in the same position as a Dayabhaga undivided family and the appropriateness of assessing the latter as a unit has been discussed in paragraphs 62 to 64. We think it right to invite attention here to a passing observation *in the matter of Keshardeo Chamria*—1937 I.T.R. at page 259 Dealing with the effect of a preliminary decree for partition among members of a Mitakshara family, the learned Judge says "The members of such a family appear to me to be in the same position as the members of a Dayabhaga family and it has never been suggested so far as I know that members of such a family cannot be individually assessed in respect of their shares." The second part of the observation if intended as a general proposition was obviously an incorrect assumption. It was not even necessary for the purposes of the case because on the facts of the case and the terms of the order before them both the parties had been collecting the rents on their joint receipt and *dividing them equally* (see observation at the bottom of page 256). When the case was before the Privy Council (*Keshardeo Chamria* v. *Commissioner of Income-tax, Bengal*—1939 I.T.R. 394) their Lordships limited their judgment to the question of the applicability of section 41 of the Income-tax Act to the facts of the case.

73 A grievance has been made in a few of the replies as to the state of the law applicable to cases where a partial partition has taken place. We see no difficulty or unfairness here. The expression "partial partition" may connote two types of cases: (i) cases where one or some only of the members go out of the family, (ii) cases where only a portion of the family property is divided. In the first case, the outgoing members will be separately dealt with for purposes of taxation and the remaining members will be treated as a joint family. In the second type of cases, the law as explained by the Privy Council in Sundersingh Majithia's case (1942 I.T.R. 457) is clear enough.

74. A representation (from the Vyapra Mandal, Gorakhpur) has asked that ways to facilitate partition may be provided if joint families cannot be treated as partnerships for purposes of income-tax law. The method of bringing about a partition in a joint family has been greatly simplified by a long course of authoritative decisions laying down that a declaration of intention to become divided is sufficient to bring about a division in *status*. But as already explain-

ed this must be followed by a division of the property, to make an individual assessment of the members possible. If some of the members of the family prove obstructive, recourse to law cannot be helped; but decisions have held that from the time that a coparcener's claim for a division is *resisted*, he may become entitled to his *specific* share of the family's income.

SECTION 14(1)—EFFECT OF THE SECISIONS

75. The exemption provided for in section 14 (1) is and has always been recognised to be a corollary of the principle of assessing the Hindu undivided family as a "unit". Till 1944, the sub-section ran as follows:—"The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family"; in 1944, the words "where such sum has been paid out of the income of the family" were added. The reason and occasion for this addition we shall presently state. Some of the decisions interpreting the clause (as it originally stood) have dealt with the matter more as turning on the construction of the words employed in the clause than as part of a special scheme of assessment. The difficulty has arisen from the fact that the Hindu law conception of an "undivided family" is wider than what has been held to be the scope of the possibility of a "family" assessment under the Income-tax Act.

76. A familiar illustration will help to elucidate the point. Take the case of a family consisting of two coparceners and thtir wives. When one of the coparceners dies leaving a widow, the joint property survives to the surviving coparcener (apart from the effect of recent legislation) and the deceased coparcener's widow becomes entitled to maintenance. According to the Hindu law, the "joint family" as such does not thereby cease to exist; this view has been rested on two grounds: (i) not only sharers (or coparceners) but even persons entitled to maintenance from the family property are connoted by the expression "joint family", and (ii) the joint family is not necessarily at an end, even after the death of the last surviving coparcener because as long as there are widows who can adopt, there is the potentiality of bringing coparceners into existence. On the first of these grounds, the Madras High Court in *Vedathanni* v. *The Commissioner of Income-tax, Madras*—1933 I. T. R. 70—and the Bombay High Court in *Commissioner of Income-tax, Bombay* v. *Gomedali Lakshminarayan*—1935 I. T. R. 367—held that the income received by the survivor from the property which survived to him was liable to be asstssed as the income of a Hindu undivided family A different view was taken by the Calcutta High Court *in re Moolji Sicka and others*—1935 I. T. R. 123. When the matter went before the Privy Council on appeals from both the Calcutta decision and the Bombay decision, their Lordships of the Judicial Committee overruled the Bombay view in *Kalyanji Vithaldas and other* v. *Commissioner* of Income-tax, Bengal—1937 I. T. R.90—and *Commissioner of Income-tax, Bombay* v. *A. P. Swamy Gomedalli*—1937 I. T. R. 416—. They held that what the Income-tax Act was concerned with was the ownership of the property and of its income in the ordinary sense and not lesser rights or interests like rights of maintenance or the possibility that in particular contingencies the owner may be divested wholly or in part (as on an adoption by a widow). They declined to attach importance to the fact that "in an extra legal sense and even for some purposes of legal theory, ancestral property may perhaps be described and usefully described as family property"; they added "it does not follow that in the eye of the Hindu law it belongs, - save in certain circumstances, to the family as distinct from the individual". In *Commissioner of Income-tax, Punjab* v. *Krishna Kishore*— (1942) I. L. R. 23 Lahore at page 34—they observed "Income is not jointly enjoyed by the party entitled to maintenance and the party chargeable" (see also *Msi. Pannabai* v. *Commissioner of Income-tax, C. P. and U. P.*—1943 I.T.R. 154).

77. If the connection of section 14 (1) with the assessment of a Hindu undivided family as a unit is not to be ignored, it will follow that in cases like those dealt with in the previous paragraph, the recipient of maintenance from a person who was once a joint owner but has since become sole owner of what was once "joint property" cannot claim the benefit of the exemption under section 14 (1). As pointed out by the Privy Council in *Raja Bejoy Singh Dudhuria* v. *Commissioner of Income-tax, Bengal*—1933 I. T. R. 135—where the owner for the time being is assessed only as an "individual", the proper course will be to deduct maintenance charges payable by him before fixing the amount for which the individual could be assessed. Their Lordships left open the question whether in such a case the maintenance amount will be liable to tax in the hands of the maintenance holder; but it could not have been the intention of the law that that amount should altogether escape income-tax.

78. The scope of section 14 (1) directly came up for decision in *Commissioner of Income-tax, C. P. and U. P.* v. *Musammat Bhagwati*—1947 I. T. R. 409 P.C.—on appeal from *Bhagwati* v. *Commissioner of Income-tax, C. P. and U. P.*—1941 I. T. R. 31. To appreciate the effect and implications of the judgment of the Privy Council, it will be convenient to take note of the material facts of the case. Out of four brothers S, K, R, and G (governed by the Mitakshara law), K. died leaving a widow B. After some disputes, an agreement was reached in October 1919, under which the surviving male members agreed to pay B maintenance at Rs. 1,000 a month. In 1923, the male members became divided *inter se* and they agreed among themselves that one group should pay B Rs. 500 and the other group pay the balance of her maintenance. B was not directly a party to this arrangement of 1923. The question for decision was whether B could claim that this maintenance allowance was exempted from tax by section 14 (1). The Commissioner's view was that after the division arrangement of 1923, there was "no undivided family in existence" and accordingly the maintenance amount could not be said to be "received by her as a member of a Hindu undivided family". There were other contentions in the case to which we do not think it necessary to refer. The High Court held that as B was a member of the Hindu undivided family before 1923, the division arrangement of that year to which she was not a party did not affect her position and she "continued to be a member of a Hindu undivided family with each of the entities into which the family disrupted, irrespective of whether any such entity consisted of one male member or of several male members". In concentrating their attention on the question as thus presented, the learned Judges do not seem to have directed themselves to the question whether after 1923 the male members were assessed as "individuals" or as a "family" and though they refer to the decision of the Judicial Committee in *Kalyanji Vithaldas and others* v. *Commissioner of Income-tax, Bengal*—1937 I T.R. 90—it does not seem to have occurred to them, that here could be no assessment *as a family* if in one of the branches there was only one male member with whom B could be deemed to have been undivided. When the case was before the Privy Council, their Lordships referred in passing to the connection between section 14 (1) and the treatment of the Hindu undivided family as a unit of taxation, but on the construction of section 14 (1) they held that "all that is required to be proved (by the recipient of the maintenance) at the time of the assessment in order to claim exemption under the section is that she is receiving the sum in question in her capacity as the widow of a deceased coparcener of a Hindu undivided family". Dealing with the effect of the division in 1923, they said "The respondent (widow) was not a party to the partition: it is true that the coparceners can break up the family but they cannot by so doing deprive the widow of her right to receive maintenance as a member of the Hindu undivided family. In their view, the question, to

which of the groups the respondent belongs after the disruption of the joint family in 1923, does not arise for decision in this case". In the view stated by them, it could have made no difference even if the widow had been a party to the arrangement of 1923 in the sense, for instance, of directly distributing between the several branches the amount of Rs. 1,000 originally fixed for her. That will not *separate* her from them but only emphasise her claim as against each of the branches. In laying stress on the nature or basis of the widow's right *when it originated*, the Privy Council wholly dissociated the operation of section 14 (1) from the question whether at the time when the payment in respect of which the exemption is claimed was made there was an undivided family which was being assessed or capable of being assessed as a *unit*. With all respect, it seems doubtful whether this view gives effect to the scheme or policy of the Income-tax law.

79. To make it clear that the exemption can be claimed only when the assessment was made on the family as a unit, the words "where such sum has been paid out of the income of the family" were added at the end of section 14 (1) in 1944, *i.e.*, after judgment had been given by the Allahabad High Court in Bhagwati's case, but before the case had been decided by the Privy Council. It is doubtful if the addition of these words will suffice to bring out the true legal position; on the other hand, they may create new difficulties. Our first comment on the newly added words is that they do not clearly bring out the idea that the exemption can be claimed *only* in cases in which the sum to which the claim relates forms part of income which *could have been* made the subject of the assessment of a Hindu undivided family as a *unit*. We advisedly say *could have been* because the law does not require that the family should have actually paid income-tax. In this respect, sub-section (1) of section 14 differs from clauses (a) and (b) of sub-section (2) of the same section. The decisions to which we have referred *supra* and numerous other cases assume that a single male member and a number of widows (or other persons) entitled to maintenance may constitute a "family" but there can be no assessment *as a family* in such cases. In *Commissioner of Income-tax* v. *Sarwan Kumar*—1945 I.T.R. 361—the Allahabad High Court held that even the existence of at least one male member was not necessary. The words "paid out of the income of the family" will not exclude the claim for exemption in such cases. Again, take the case where an undivided family resides in one of the Indian States and is therefore not liable to be taxed under the Act but a maintenance holder belonging to that family resides in British India and therefore receives or brings his maintenance amount here. Section 14 (1) even in its present form can be pressed into service by such a maintenance holder, because there is no reference in it to the taxability of the family income as a condition precedent. On the other hand, the expression "has been paid out of the income of the family" may serve to exclude cases which could not have been intended to be excluded. For instance, a coparcener who has to pay maintenance to a woman may as a *matter of convenience* pay her by a cheque drawn on a bank where he keeps his separate funds; it is open to him to adjust his accounts with the family at any time he likes; the recipient cannot be prejudiced by the fact that the cheque is drawn upon one bank account rather than on another. The true test must be whether the amount is paid in satisfaction of a claim *payable* out of the income belonging to the joint family. Bearing considerations like the above in mind, we would suggest that section 14 (1) may be recast as follows:—

> "The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family out of income in respect of which the family itself has been or can be assessed as a unit."

80. It will follow from the above discussion that where a person who is assessed only as an individual has to pay maintenance to other members of the

family who are not sharers (including illegitimate descendants or disqualified males who are only entitled to maintenance) the principle of the decision in *Raja Bejoy Singh* Dudhuria v. *Commissioner of Income-tax, Bengal*—1933 I.T.R. 135—will apply, with the result that the maintenance amount will have to be deducted before determining the assessable income of the individual. We must, however, point out that it will be hard on the maintenance holder if his or her immunity from taxation should be made to depend on the accident of the number of "sharers" in the family property remaining more than one or becoming reduced to one. The proper course will be to continue the exemption even after the assessment of the family has become an "individual' assessment, and if the Government is not prepared to lose the tax on the maintenance amount, an express provision may be inserted in the Act excluding the application of the decision in the Dudhuria case (1933 I.T.R. 135) to certain defined categories. This course will, in our opinion, be fair at least in cases in which the maintenance amount was fixed at a time when the family was being assessed as a unit, because the amount would then have been fixed on the assumption that income-tax would be borne not by the recipient of the maintenance allowance but by those paying the allowance.

81. The above discussion furnishes the answer to another question raised, *viz.*, the application of section 14 (1) to maintenance paid to the junior members of families owning impartible zamindaris. The full execution of the policy of abolition of zamindaris may greatly reduce the practical importance of this question. It must now be taken as settled that so far as the *income* from the impartible estate is concerned, it is the individual income of the proprietor; it can only be made the subject of individual assessment. Here as well as in other cases of maintenance, the problem will be complicated by the fact that the person paying the maintenance may have both agricultural income and assessable income. Some kind of apportionment rule must be followed in determining how much of the maintenance amount can be deemed to have been paid out of he agricultural income and how much out of he assessable income.

Residence of Hindu Undivided Family

82. Section 4-A (b) enacts that a Hindu undivided family is resident in British India unless the control and management of its affairs is situated wholly without British India. In the light of our remarks in para. 31 *supra* about residents of Indian States having sources of income in the Indian Union, this definition may require modification. Section 4-B (b) lays down when a Hindu undivided family is deemed to be *ordinarily* resident in British India. Annotators on the Act have expressed themselves unable to see the significance or utility of the provision in section 4-B (b). So far as the amending Bill of 1938 made reference to 'domicil', there was need to define the domicil of the "undivided family" by reference to the domicil of the manager (see clause 5 of the Amendment Bill). But when domicil ceased to be a material factor, the situation changed. Anyhow, as we have recommended the abolition of the category of "not ordinarily resident", the double negative process by which we have to frame the concept of "ordinarily resident"—because this expression is not as such defined in the Act—is no longer called for and section 4-B (b) may well be omitted.

83. The definition of residence is material both to the question of assessability and to the question of "local jurisdiction" under section 64. Sections 4-A and 4-B only help to determine the question of residence "in British India" but not the choice of a place for purposes of section 64, if the Hindu undivided family derives income from more than one place in British India. Sub-section (1) of section 64 provides a rule of choice in respect of "business, profession or vocation" carried on in more places than one; where the family has only other sources of income, sub-section (2) merely gives jurisdiction to the Income-tax Officer of the area 'in which he resides'. There must be

some rule of choice provided for cases where such other sources lie in different areas, unless it is assumed that sub-section (3) is sufficient to meet such cases.

C.—Taxation of Companies

(Question 7, 8, 15, 16 and the first half of question 9.)

84. Q. 7, 8 & 9. In a few of the replies and other representations sent to us, our attention has been drawn to the alleged defects and undesirable potentialities of the Managing Agency system. That is a matter pertaining to the general law relating to companies and is not within our purview. Though question 7 covers both public companies and non-public limited companies, we do not propose to deal at length with the former. Public companies generally attract a large number of middle class shareholders and many of them may be seriously prejudiced if the companies are subjected to super-tax at a progressively increasing rate. If such super-tax is levied, it will not be fair to exclude the application of section 49-B to such cases. The work of the Department in dealing with refund applications will then be greatly increased without any commensurate benefit to the revenue. The chances of companies of this kind being formed for the purpose of avoiding tax are not many and their dividend policies are not likely to be greatly affected by consideration of the amount of tax which individual shareholders will have to pay. In the replies that we have received, the weight of opinion is strongly against the substitution of a regular super-tax in place of the present corporation tax (though even this is often spoken of as super-tax). We propose, therefore, to deal mainly with non-public limited companies.

85. Strongly emphasising the need for encouraging the growth of joint-stock enterprise in this country, Mr. Manu Subedar has suggested (i) that even the corporation tax of two annas in the rupee should be abolished, and (ii) that on dividend income received by shareholders, super-tax should be imposed only at a flat rate of 2 annas in the rupee. In support of the first suggestion, he has pointed out that during the early years of a company's existence, even the two anna rate is a heavy burden; the second suggestion he recommends as calculated to induce the recipients of dividends to invest such income also in the expansion of joint stock business. He has linked these proposals with a futher proposal that Government should be entitled to claim one half of the surplus profits in every company after a dividend of 6 per cent. has been paid and after depreciation has been adequately provided for. This last proposal is a matter for agreement between the Government and the business world and as the other proposals are linked with it, we say nothing more about them. He has, however, expressed himself in favour of the abolition of non-public limited companies on the ground that in most cases they are used for the evasion of taxes.

86. In some of the replies that we have received, great stress has been laid upon the important and useful role which non-public companies have played and have yet to play in the growth and development of private enterprise. Stress has also been laid on the right of businesssmen to carry on business in their own way. We need not and do not deny these claims; but they cannot negative the right of the State to step in when the legitimate use of the machinery of incorporation gradually gives place to a fictitious use for purposes of tax avoidance. As has often been pointed out, we must of course take care to see that the scheme has tax avoidance for its purpose and that tax-escapement—large or small—is not merely a bye-product or the mere result of a legitimate and unexceptionable method. In some instances, it may be useful to enquire what advantage the incorporation could have been expected to secure if not escape from tax. It is the rising burden of super-tax that has led to the adoption of methods of avoidance through the media of companies. Normally, incorporation is a means for collecting capital from many persons and insulating

individual investors from personal liability for the operations of the concern. The influence of shareholders is presumed to control the conduct of the business and the distribution of dividends in the interests of the general body. But what is the position in the case of an "incorporated" family partnership? The very intention of forming such a concern is, in most cases, to keep membership within very narrow limits, such as a family or a circle of friends. Such a concern carries on business after incorporation, in much the same manner as the partnership did before or would have done. It is directly controlled by the individual members who continue to be actively engaged in its business operations: only, they receive salaries and dividends instead of their share of profits. They can certainly influence the dividend policy of the company with an eye to its effects on their tax-liability. It ordinarily has no liabilities to the outside world but liabilities to the members themselves or to their relatives are often created for tax purposes. Apart from difficulties in determining the genuineness of such alleged loans, this makes it possible for those responsible for the management to accomplish substantial tax savings through concentration of interest payments in the years when taxable income is large. As long as the Excess Profits Tax was in force, the temptation to cut up one business into a number of concerns was increased by the desire to show that the income of each unit was below Rs. 36,000. A similar temptation is likely to be offered by the provision in the new Finance Act reducing the rate of tax payable by a company whose total income does not exceed Rs. 25,000.*

87. It has been argued that Government do not lose much revenue in the long run by the formation of non-public companies: it has been said that (i) the loss of benefit relating to earned income privileges, (ii) the payment of corporation tax, (iii) the limitations placed by section 16(3), and (iv) the compulsory distribution of dividend under section 23-A, take away many of the advantages of bringing into existence separate entities in the form of private companies. It may be conceded that tax-dodging devices of this kind may be too expensive unless large sums are involved. But, when incomes are in the higher grades, charges by way of corporation tax, etc., will be found to be much lower than the taxes which should be levied if the income had been directly received by the individual, because the super-tax upon the individual is in these grades much in excess of the corporation tax. Section 16 (3) is easily evaded as its operation is limited to dispositions in favour of one's wife and minor children. Section 23-A no doubt affords a valuable check, but the following paragraphs extracted from the report of the Australian Royal Commission on Taxation (1932-33) will show how even its operation can be largely checkmated.

"688. X. and Y. are equal partners in a business which manufactures and distributes two distinct products. Desiring to reduce the tax for which they would be liable if they continue to trade as a partnership they proceed as follows:—

First step.—They incorporate three private companies. Company A. purchases one factory. Company B. purchases the other factory. Company C. purchases the finished stock and book debts, and controls distribution of the products of Companies A. and B. The consideration for sale is in each case the allotment of shares in each company equally to X. and Y.

Second step.—They next incorporate company D., to which they sell the shares they have received from Companies A., B. and C., the consideration being the allotment equally to X. and Y. of shares in Company D.

Third step.—X. now incorporates Company E., consisting of himself and the members of his family. He sells to it his shares in Company D., the consideration being again paid in shares. Some of

these shares are allotted or transferred by X. to the members of his family. Y. incorporates company F. with the same capital as Company E., and follows exactly the same procedure as X.

The following diagram will make it easier to understand the procedure adopted:—

First step		A. Manufacturer	B. Manufacturer	C. Distributor
Second step			D.	Holds all shares in Companies A., B., C.
Third step	Holds half share in D.	E.	F.	Holds half share in D.
		X. and family.	Y. and family.	

689. The profits of Companies A., B. and C. for the first year are as follow. In each case two-thirds is distributed as dividend to Company D.

(NOTE.—This is under a provision similar to section 23-A of the Indian Income-tax Act.)

	Profit £	Dividend £
Company A.	30,000	20,000
Company B.	7,500	5,000
Company C.	4,500	3,500
	42,000	28,000

Commonwealth tax is paid by each company on its profits at 1*s*. in the pound. Company D. has no income those dividends amounting to £28,000 which it has received from companies A., B. and C. These are free of tax in its hands by reason of the rebates to which it is entitled in its capacity as a shareholder. It distributes two-thirds of this amount as dividends equally between companies E. and F. Companies E. and F. each receive £.9,333 as dividend from company D. free of tax. Each distributes two-thirds of this amount as dividends to its shareholders.

690. It should be noted that none of the companies is liable to additional tax under section 21, as each has distributed two-thirds of its taxable income. To avoid a confusion of the real issue special property tax is ignored in the example.

691. The net result of this complex scheme is that the profits still remain the property of the former partners in the same proportion as they did before the companies were formed. They have avided payment of tax on profits which they have not withdrawn (except to the extent of 1*s*. in the pound which was paid by the companies.) The advantage of the arrangement is shown by the following table of the taxable income of each partner in the circumstances stated:—

	Taxable income £
(a) As a partner—as income from personal exertion	21,000
(b) If only one company had been formed—dividends—as income from property	14,000
(c) As a result of the scheme described—dividends—as income from property	

Tax on dividends under (b) and (c) would depend upon the manner in which each partner has distributed the shares he received from company D".

88 The following further paragraphs of the report also deserve to be quoted:—

"692. In the examples given, the taxpayers concerned have been content to form only three successive companies or groups of companies, but the only practical limitation to the number of successive companies that might be formed is that the distributable income of the last company must be sufficient to provide for the dividends required by the promoters for their individual use.

693. It is not suggested that Income Tax legislation should interfere with the right of the taxpayer to form a private holding company with as many subsidiaries as he may consider he requires for the purpose of his business. But if he does so he should not be placed in a better position for the purposes of taxation than he would have been if the whole of his interests were represented by one company. The acceptance of this principle is essential to preserve equity between shareholders of private holding companies and other private companies.

694. In order to prevent avoidance of tax by the formation of private holding companies, we recommend that dividends received by one private company from another shall, to the extent to which such dividends form portion of the distributable income, be deemed to be distributable in full for the purposes of the calculation of additional tax under Section 21".

89. The law in India will not permit of this kind of device being carried quite so far as is assumed to be possible in the above paragraphs, because corporation tax at 2 annas in the rupee has to be paid at each step. Cases are, however, conceivable where in spite of the corporation tax a second step, if not also a third, may be attempted profitably. If some provision even less stringent than that suggested in paragraph 694 above extracted is made, with a view to check such attempts, we do not think it necessary or worthwhile to go the length of the suggestion made in question 8, viz., that non-public limited companies may be assimilated to partnership (*cf* section 105 of the Australian Act of 1936). In paragraph 667 of their report, the Australian Commission have given reasons against a similar proposal made before them. We are suggesting in para 82 that it may be left in all cases to the *discretion* of the I. A. C. to exercise the power under section 23-A. A like discretion may be given to him to insist on full distribution (and not merely 60 per cent) in cases in which one non-public limited company does no business of its own but merely receives dividends from another, because in such cases there is little necessary for the holding company to build up a reserve. Government may also consider the expediency of introducing into the Indian Companies Act changes recently made in England on the report of the Cohen Committee. These changes include some additional safeguards in respect of the administration of private limited companies.

90. A few minor questions raised in some of the replies with reference to the operation of section 23-A may be conveniently dealt with here. It has been urged—(1) that section 23-A should be amended so as to provide that the 60 per cent prescribed thereby should be 60 per cent of the profits *as shown in the company's account books*, (ii) that in the case of banking companies, section 23-A should be so applied as to make allowance for the share of the profits which under section 277-K of the Indian Companies Act they are compellable to transfer to the Reserve Fund, (iii) that in determining the assessable income for the purposes of section 23-A, public charges like municipal taxes,

cesses, etc., which the company will be bound to pay should be allowed as legitimate deductions, though they may not be permissible deductions for purposes of assessment of income-tax, and (iv) that in calculating the distributable income, items actually disbursed but disallowed by the assessing officer should either be treated as having been distributed or should be excluded from the assessable income, because they are not in fact available for distribution.

91. The first suggestion obviously asks for too much. As to the second, we may observe that one of the purposes that section 23-A had in view in excluding 40 per cent of the profits from compulsory distribution was to enable the concern to build up a reserve. In the case of banking companies the formation of such a reserve is up to a limit insisted on by the law instead of being left to the discretion of the management. The margin of 40 per cent is sufficient to permit a banking company to comply with section 277-K of the Companies Act even while distributing 60 per cent of its income as dividend. Where, however, 60 per cent has not been distributed and as a kind of penal consequence an order has to be made to the effect that the undistributed portion of the assessable income shall be deemed to have been distributed as dividend, it seems to us reasonable to provide that such notional distribution shall be subject to the provisions of section 277-K of the Companies Act. The penal consequence contemplated by section 23-A was that the defaulting company should be treated as a partnership and that a declaration of dividend need not be insisted on. It could not have been the intention to include such portions of the income as are precluded by law from being included in a declaration of dividend. The third suggestion seems to us reasonable. An honest declaration of dividend cannot include amounts which under the law the company was bound to pay for public charges. The mere fact that the Income-tax Act does not allow such items to be deducted when calculating the assessable income will not reflect on the reasonableness of the conduct of the company, nor does it seem to us fair to insist that even such public charges should be met out of the 40 per cent excluded by section 23-A. We accordingly recommend that in determining the assessable income for the purpose of section 23-A, public charges should be excluded.

92. In dealing with the fourth of the above suggestions, it has to be remembered that by referring to the "assessable income", the section has excluded all revenue expenses and permissible deductions. It is nevertheless possible that by reason of difference of opinion or in method of calculation between the assessing officer and the company's officers, the amount distributed may prove to be less than 55 per cent insisted on by the second proviso to section 23-A as a condition precedent for giving a *locus penitentiae* to the company for escaping a penal order under this section. As such situations may arise even from honest difference of opinion, the second proviso to section 23-A may be enlarged so as to include cases where the distribution actually made has fallen short of 60 per cent of the assessable income by reason of the assessing officer determining the assessable income to be greater than it was according to the calculations made by the company. Even after this relaxation, some cases may present special features. In systems where the ratio of dividend to be distributed is not arithmetically fixed but the law only insists on a "reasonable distribution", cases presenting special features may be dealt with as the justice of each case requires, in the exercise of the discretion which the words "reasonable distribution" allow to the revenue authorities. (cf. the decision of the House of Lords in *Fattorini Ltd.*, vs. *Inland Revenue Commissioners*—11 I.T.R. Supplement, p. 50). But, as section 23-A, has specifically fixed the ratio, the field of special discretion is almost excluded. We understand that in practice orders under section 23-A always receive consideration from the

Central Board of Revenue which takes care to exercise such discretion. It, however, seems to us that it will be more regular to provide for the exercise of such discretion in the statute itself. Even as it stands, section 23-A authorises the Income-tax Officer to make an order under sub-section (1) of that section only "with the previous approval of the Inspecting Assistant Commissioner". But it is possible to contend that all that the Inspecting Assistant Commissioner can consider when asked to approve of a proposed order by the Income-tax Officer is whether the conditions prescribed in the sub-section have been satisfied and not exercise a discretion *de hors* the section. We therefore think it desirable to indicate that the Inspecting Assistant Commissioner has some measure of discretion even when he finds that the conditions prescribed by the opening words of the sub-section exist. Sub-section (2) of the section provides that the Inspecting Assistant Commissioner shall not give his approval to the Income-tax Officer's proposed order until he has given the company concerned an opportunity of being heard. To this we would add a further provision to the effect that the Inspecting Assistant Commissioner may for reasons to be recorded by him in writing withhold his approval even when he finds in agreement with the Income-tax Officer that the conditions prescribed by the opening words of sub-section (1) exist.

Treating Salaries and Loans as Distributions of Dividends.

(Questions 15 & 16)

93. One of the results of incorporation is that sums paid as salaries to directors and shareholders-employees will ordinarily become admissible deductions when determining the assessable and distributable income of the company. A question may arise in some cases whether the salary was reasonable and whether the payment was not in effect a distribution of profits. Where the salary is paid to such of the shareholders as are the principal persons behind the company, whether they be directors or not, the probabilities will be that they will have their own taxable income and the salary will merely add to that taxable income, so that the only chance of loss to the revenue in such cases will arise out of the difference in taxation rates between earned income and unearned income, because dividend will be classed as unearned income. If it is clear that the Income-tax Officer has power to determine the reasonableness of the amount paid in relation to the services rendered—and this is sometimes claimed to be the result of the decision in the *Aspro case* (L.R. 1932 A.C. 683)—nothing further need be said on this point (see also Copeman *v.* William Flood and Sons —L.R. (1941) 1 K.B. 202 = 1941 I.T.R. Sup. 85). If the amount is paid to a dummy whose taxable income may not be large, the principle of the decision in the Aspro case will probably also suffice to enable the Income-tax authorities to determine whether the payment represents genuine salary or not. In exercising this power, the Income-tax authorities may, however, have to bear in mind the following observations of the Australian Royal Commission:—"The legitimate scope of enquiry seems to me whether the payments to directors are in fact salary or in fact a distribution of profits. In cases where they are clearly payment for services rendered, the question whether they are more or less than the services are worth is irrelevant.........The amount of so-called salary paid to the directors taken in connection with other circumstances may be very material as a guide in determining whether or not it is in while or in part really a dividend in disguise. The Commissioner must make the decision in each case upon a consideration of all the circumstances of that case . . . If the director holds a controlling interest in the company and is in a position to determine his own remuneration, the solution becomes more difficult. Possibly the most helpful line of approach as a general rule would be to look into the accounts of other

companies doing a resonably comparable business, see what salaries are paid to persons occupying corresponding positions in those companies and so obtain something in the nature of a standard to be applied with such modifications as any special circumstances in the case might seem to require. The same principle would apply to the consideration of cases where the salaries paid to the members of a director's family come into question." (see also the observations of the Judicial Committee in *Minister of National Revenue* v. *Wrights' Canadian Ropes Ltd.*—L.R. 1947 A.C. 109—On the interpretation of a provision in the Canadian Income War Tax Act which was admitted to "make the Minister the sole Judge of the fact of reasonableness or normalcy").

94. The proposal that loans to shareholders should in certain circumstances be treated as a distribution of dividend is not so easy to apply in practice. If the proposal is to be adopted, a difference must be made between companies with money-lending as part of their regular line of business and companies not doing money-lending business (compare section 18 of the Canadian Act). In the former case, there will be much less justification for treating the loan as a disguised distribution of dividend merely on the ground that the borrower happens to be a shareholder. In Australia, the subject is specifically provided for in section 108 of the Income-tax Act. In Ratcliffe's Income-tax Law, a case (of *Jacob* v. *Commissioners of Inland Revenue*—(1925) 10 Tax Cas. 1) is referred to on page 721, where the court of session in Scoutland is reported to have up-held the finding of the Commissioners to the effect that the amount of a loan advanced by a non-public company to the controlling shareholder represented income liable to super-tax. This would suggest that even in the absence of a specific statutory provision on the point, the Revenue authorities have the power to determine the real nature of the transaction; but it would be obviously desirable to define such power clearly by a specific statutory provision. If loans should in certain circumstances be treated as distribution of dividends, they should of course be taken into account in the application of section 23-A.

95. It remains to say a few words upon two more questions that may arise in respect of the assessment of non-public limited companies: (1) Should the Department have any and what remedy if a non-public limited company is wound up before the tax due from it can be assessed and recovered? (2) Whether the Department should have any and what power to deal with what may be suspected to be a bogus company? The first question may be conveniently dealt with when considering the points raised by questions 39 and 40 (paragraphs 189 to 192). As regards the second, we may note that the Australian Royal Commission has sounded a warning against conferring wide powers on the taxing authorities to refuse to recognise a company as an independent legal entity, once it appears that it was intended to have a genuine existence, whatever may be the motives with which it was brought into existence. English authorities are even more insistent in emphasising the separate legal personality of the company. If the shares allotted to any person whose name appears as that of a shareholder therein could be shown to have been assigned to him only as a benamidar for the promoter, we think it must be open to the Income-tax authorities to include the dividends paid on such shares n the ncome of the real owner. If the reasoning in the recent judgments of the Bombay High Court in *S. C. Cambatta* v. *Commissioner of Income-Tax Bombay*—1946 I.T.R. 748—and Shree Shakti Mills Ltd., *v.* Commissioner of Income-tax, Bombay City—1948 I.T.R. 187—can be interpreted as precluding such a course, specific provision must be made in the Act to permit such inclusion (see in this connection our recommendation in paragraphs 181 to 188 with reference to question 36): Where the incorporation itself can be shown to be a mere blind or a pretence, *i.e.*, "without intention that it should in truth have any effect as defining the rights of the parties as between themselves", the view indicated by the Judicial Committee in Sundersingh

Majithia's case (1942 I.T.R. 457) as to a fictitious partnership should be equally available to enable the authorities to ignore the alleged company. It will be a question of fact in each case as to whether there was evidence to lead to such a conclusion. The Courts in England have felt bound by the observations in Solomon's case (L. R. 1897 A. C. 22) to emphasise the antithesis between the taxability of the profits of the company as such and the taxability of so much of it as may reach the shareholders in the shape of dividends. The antithesis had significance in the days when a non-public limited company could keep a large portion of its profits undistributed. After the introduction of the rule embodied in section 23-A of the Indian Income-tax Act, only a limited extent of tax evasion is possible by the resort to the formation of a company which in effect is the private concern of one or two individuals. Respect for legal form may in some cases require evidence to justify a finding that the company was carrying on business as the agent of the individual. The judgment of the Court of Appeal in *Inland Revenue Commissioners* v. *Sansom* (L. R. 1921—2 K. B. 492) recognises the possibility of the conclusion that the business alleged to be carried on by the company was in truth the business of an individual (see *In re. Sir D.M. Petit*—I.L.R. 51 Bom. 772 for a full discussion of the authorities)

D.—Partnerships

(Questions 10 and second half of Question 9.)

96. We have been pressed (by many of the replies) to abolish the distinction between registered firms and unregistered firms. We feel that the considerations which induced the Ayers Committee to encourage registration of firms are no less effective today than in 1937. Only, the experience of the war years seems to show that even the system of registration does not make things easy for the Income-tax authorities. The existence of a deed of partnership is normally assumed to obviate difficulties in ascertaining the exact facts as to the proprietorship of a business, but if the document is not intended or expected to state the true facts its existence and registration only add to the difficulties of the assessing officer. So long as the [illegible] intermediary concerns with a view to show a reduced profit for the principal concern subsists, Income-tax authorities must have the power to go behind the document and determine the person or persons into whose pockets the profits of the nominal partnership have gone. Cases have come to our notice where there is reason to suspect that *employees* of the main concern or even dependants were put forward as partners of the intermediary concern, sharing its profits between themselves. But they really continued to be only paid employees and the profits went to swell the profits of the main concern. For these reasons, it is necessary to insist that the production of a deed of partnership should not automatically entitle the persons producing it to have it registered by the Income-tax authorities and that registration should not preclude the authorities from going behind the document—if there arises ground for suspicion—and determining who has the real control over the income. Similar considerations apply to cases where the deed is not wholly fictitious but does not disclose the whole truth as to the rights and interests of the different sharers (as to the present state of the law, see (1948) 2 Madras Law Journal at pages 433 to 435 and the authorities there cited).

97. In view of the prevalence of malpractices of the kind above stated, it has been suggested in one of the replies that the assessment of all firms, whether registered or unregistered, may be assimilated to the practice now governing the assessment of unregistered firms but with some differences. The sug-

gestion is to the effect that the alleged partnership, whether genuine or not, may be assessed like any individual on its total income (including liability for super-tax) but that the shares of the respective partners in the said income should also be assessed as part of their individual income subject, however, to credit being allowed in their individual assessment in respect of the proportionate amount of tax paid by the partnership. This will substantially assimilate the partnership to a company except for the suggestion that even super-tax should be levied on the firm at the appropriate rate and not merely the corporation tax. If refunds are also to be allowed to the individual partners on the lines provided for in respect of companies under section 49-B, there will be little to gain by adopting the company method of assessment, because either the authorities must go into the truth of the story as to who the partners are and what their shares are before the refund claims can be properly disposed of, or they must accept the statements of the parties. This will not, therefore, save any trouble for the assessing authority. It has accordingly been suggested that there should only be a right of deduction in respect of the individual assessment of the alleged partners but no right to claim refund if their income is not taxable or not taxable at the same rate as the partnership income. This will be scarcely fair to persons with comparatively subordinate interests even in honest partnerships. The law contemplates the possibility of employees being remunerated by a share in the partnership; and other instances are well-known where genuine partners have comparatively minor shares in a partnership. We are therefore unable to adopt a suggestion which will result in injustice to such cases.

98. Inspite of the considerations mentioned in the preceding paragraphs, registration has some advantages and to encourage registration as far as possible, it is necessary to maintain the distinction between registered and unregistered firms. The Ayers Committee thought so much of these advantages that they recommended registration to be permitted at any time, up to the determination of an appeal against the assessment. They thought that the danger of ante-dated partnership deeds being specially drawn up to affect the apportionment of profits should disappear if their recommendations in Chapter VI, Section 2, were accepted. We are not sure that this expectation has been realised. As already stated there is at present a considerable time lag between the termination of the accounting year and the commencement of assessment of income in respect of the profits of that year. This enables assessees, if so minded, to make it appear that the profits of a *good* year really belonged not to one person but to a number of partners and in support of this attempt an antedated partnership deed or a deed reciting the commencement of the partnership at an earlier date is produced. Registration of the deed by the income-tax authorities, if it is to be useful, must, therefore, be registration within a short interval—say three or at the highest six months—after the commencement of the partnership. There may be a provision for excusing delay if justifying cause is shown.

99. We are not sure if registration under Chapter VII of the Indian Partnership Act or under any legislation corresponding to the English Registration of Business Names Act will permit an investigation of the kind of questions that we have referred to in paragraph 96 *supra*. Further, such registration will raise questions of general law and not merely Income-tax law. We do not, therefore, think it right to recommend that registration under any general law should take the place of registration under section 26-A of the Income-tax Act. If a partnership has been registered under the Partnership Act, that registration affords some guarantee that the partnership or the document relating thereto had come into existence on the date of the registration and the chances of subsequent fabrication are minimised. In such cases, the time-limit of three or six months which we have recommended in the preceding paragraph for

istration of the partnership deed before the Income-tax Officer may be extended, say to the end of the accounting year.

100. The suggestion that provisions similar to sections 10 and 10-A of the Excess Profits Tax Act may be embodied in the Indian Income-tax Act has evoked strong opposition. It is rightly pointed out that the Excess Profits Tax Act was an emergency measure and that considerations relevant to it are not exactly relevant to the ordinary Income-tax law. It has also been urged, probably with truth, that even in the administration of the Excess Profits Tax Act, these provisions have rarely been successfully applied and the attempt to apply them has only led to prolonged litigation and bitterness. We do not, therefore, recommend provisions on the lines of sections 10 and 10-A of the Excess Profits Tax Act being inserted in the Income-tax Act, but we consider that powers of the kind referred to in paragraphs 95 and 96 *supra* (both in respect of non-public limited companies and of partnerships) are necessary, and if, as has sometimes been suggested, there is any doubt as to the availability of such powers under the existing law, they must be specifically provided.

E.—Mutual Associations.

(Question 11)

101. The law relating to the taxability of the income of various kinds of mutual associations can scarcely be said to be clear or definite. In the absence of specific legislative provisions, the case-law both in Egland and in India has had one may almost say a chequered history. The precise implications of the decision of the House of Lords in Styles' case (L.R. 14 A.C. 381) have long continued uncertain. Decisions of courts have variously laid stress on the test of mutuality, the test of trade or business, the significance of the term "profits" and so on. Undue importance has sometimes been attached to the question whether the transactions of the association had been limited to members or did include or could have included non-members also. In *Cornish Mutual Assurance Co. v. Inland Revenue Commissioners*—1926 Appeal Cases at p. 287—Viscount Cave, L. C. declined to accede to the proposition that a mutual company could not be held to carry on *business. In Thomas (Inspector of Taxes) v. Richard Evans and Company, Limited—Jones (Inspector of Taxes) v. South-West Lanchashire Coal Owners' Association, Limited*—1927 1 K. B. at pp. 46-47—Rowlatt J. saw no difficulty in holding that a company can make a profit out of its members as customers even though its range of customers is limited to its shareholders. The recent decision of the Judicial Committee in *English and Scottish Joint Co-operative Wholesale Society, Ltd., v. the Commissioner of Income-tax, Assam*—(1948) 2 M. L. J. 242—has definitely dissented from the proposition laid down by the Madras High Court in unqualified terms that a society could not make taxable profits out of its own component elements. This may call for a reconsideration of some of the decisions of the Indian High Courts and the Income-tax Department may itself have to reconsider certain questions in the light of the rational of the Privy Council judgment. Beyond sounding a note of caution as to the results and implications of the Privy Council judgement, we doubt if it will be expedient to recommend any definite legislature provision at this stage, either on the lines of sections 52 (2) and 53 (2) (h) of the English Finance Act, 1920 and section 31 (1) of the Finance Act, 1933, or sections 117, etc. of the Australian Act.

102. Sub-section (6) of section 10 of the Income-tax Act was inserted in 1939 on the recommendation of the Ayers Committee. Objection has been taken in one or two of the replies that in applying this provision, items of necessary expenditure are not allowed to be deducted. We understand that the practice is to allow expenditure to be deducted in the proportion which

the taxable portion of the Association's income bears to the non-taxable portion. If, in any case, this is not being done, the matter may be looked into. If, however, the claim is that the *whole* expenditure should be allowed as a deduction from the taxable income irrespective of a part of the income being non-taxable, we believe that it will be difficult to reconcile the admission of such a claim with the general scheme of the Act. Reliance has been placed on the analogy of the provision permitting co-operative societies to set off a deficit resulting from non-taxable activities against income subject to taxation. Such a provision cannot be made applicable to *all* mutual associations. It will be for the Government to consider whether there is reason for extending the principle to any particular categories of mutual associations and if any such are found, special provision may be made for them.

F.—Life Insurance Companies

103. Certain questions relating to the levy of income-tax on life insurance companies were referred to the Commission by the Ministry of Finance on representations made to the Ministry by the Association of Life Assurance Offices in India, the Indian Life Assurance Association and the Actuarial Society of India. As these topics had not been included in the Questionnaire issued by the Commission, the Commission has not had the benefit of ascertaining the views of the public thereon. It was accordingly considered desirable to have a personal discussion with at least some representatives of the interests concerned. Three representatives, *viz.*, Mr. L. S. Vaidyanathan, Pandit K. Santhanam and Mr. L. B. Heale, kindly responded to our invitation and we have had the benefit of a full and frank discussion with them. At our request Sir Purshotamdas Thakurdas favoured us with a mamorandum on the relevant questions and later we had the benefit of a personal discussion with him. We are greatly indebted to all the gentlemen above referred to for assistance in clarifying several points.

104. Life Insurance Companies have long claimed and have been accorded special treatment in the matter of assessment to income-tax on the ground that the nature of their business does not assimilate them to ordinary commercial concerns and that the tests ordinarily applied in determining the profits of a business are not appropriate to their case. While none has gone the length of asserting that such companies make no profits at all, different views have been put forward as to how much of their incomings can be properly regarded as "profits of the company". All discussions of the question have agreed that it is not easy to find "ideal" solution. Different tests have been suggested for determining the assessable income of a life assurance company. The use of the premium income as any standard has been discarded as unscientific. Two other bases in vogue are: (i) the basis of the investment income, and (ii) the basis of the valuation surplus. In *National Mutual Life Association of Australia, Ltd. v. Commissioner of Income Tax, Bombay Presidency and Aden*—1936 I.T.R. at p. 54—the Privy Council observed that computation of the income, profits or gains on the basis of the triennial valuation reports "is the most reliable method of computation in the case of a life insurance company". They added, "The amount of interest earned on investments, though it is an element in the ascertainment of the income, profits or gains, is not by itself a reliable *datum for* such ascertainment". The investment income is not difficult of ascertainment, but different views have been entertained as to the deductions to be allowed therefrom for ascertaining the true assessable income. As regards the valuation surplus basis, it has sometimes been claimed that it is not legitimate to invoke it at all in the case of insurance companies and some system of income-tax law *e.g.* in the U.S.A.) have not adopted it. In England, the question of a single basis or of two

bases was discussed by the Royal Commission which dealt with the Income-tax law in 1920 and they affirmed that both bases were admissible. It would appear, however, that in practice, the investment income basis is nearly always adopted in England bacause that is more advantageous to the Exchequer.

105. In India, the present law relating to the levy of income-tax on Life insurance companies is contained in the rules set out in the Schedule to the Income-tax Act. The provisions relevant to the present purpose are the following:—

"2. The profits and gains of life insurance business shall be taken to be either—

(a) the gross external incomings of the preceding year from that business less the management expenses of that year, or

(b) the annual average of the surplus arrived at by adjusting the surplus or deficit disclosed by the actuarial valuation made for the last inter-valuation period ending before the year for which the assessment is to be made, so as to exclude from it any surplus or deficit included therein which was made in any earlier inter-valuation period and any expenditure other than expenditure which may under the provisions of section 10 of this Act be allowed for in computing the profits and gains of a business, whichever is the greater:

* * * *

3. In computing the surplus for the purpose of rule 2—

(a) one-half of the amounts paid to or reserved for or expended on behalf of policyholders shall be allowed as a deduction:

* * * *

Provided further that if any amount so reserved for policy-holders ceases to be so reserved, and is not paid to or expended on behalf of policy-holders one-halt of such amount if it has been previously allowed as a deduction, shall be treated as part of the surplus for the period in which the said amount ceased to be so reserved.

* * * *

106. In passing, it may be convenient to say a few words as to the history of rule 3 above quoted. It is common knowledge that insurance companies issue two kinds of policies: one set of policies called participating policies carry a bonus benefit and the other set carries no such benefit. In respect of the former, the rate of premium is somewhat higher than the rate applicable to the latter. In Insurance language, this addition is spoken of as "the [illegible]". Besides the two classes of policy-holders, there is a third-party in the business of proprietary concerns, *viz.*, the shareholders. By a well-established practice, a substantial portion (generally 90 per cent) of the surplus reached as the result of quinquennial or triennial valuations is distributed by way of bonus to the holders of participating policies and a comparatively small fraction, *i.e.* the remaining 10 per cent, is distributed as dividend amongst the shareholders. For purposes of income-tax, it has been a moot point whether the sums payable as bonus to the policy-holders should not be treated as standing on a different footing from the sums payable to the shareholders. About 60 years ago, it was laid down by a majority judgment of the House of Lords in England that the bonus paid to policy-holders is just as much liable to be taxed as "profits" of the company as the dividends paid to share-holders (see Last v. London Assurance, etc. L.R. 10 A.C. 438). Stress was laid on the circumstance that the bonus was payable only if the valuation disclosed a surplus, that is, only out of profits. But the fact that both in the Court of Appeal and in the House of Lords, there were dissenting judgments in this case is a clear indication

that two views are possible on this question. Life insurance companies accordingly kept on pressing their claim that the amount paid by way of bonus to policy-holders was only in the nature of return of excess premium paid by the policy-holders and should, therefore, be excluded from the taxable income of the company. In 1920, the Royal Commission accepted the validity of this claim and pursuant to their recommendation, a provision was inserted in the English Finance Act of 1923 (Section 16) excluding from the computation of the assessable profits such part of the company's profits as belongs or is allocated to or is reserved for or expended on behalf of policy-holders.

107. In India, the question was raised before the Ayers Committee, but its report did not accept the claims for exclusion of the bonus amount to the extent or on the grounds urged before it. It suggested a limitation of the taxable income on other lines (see Chapter VII of its report). When the matter came before the legislature, a compromise was reached to the effect that 50 per cent of the bonus amount should be excluded from computation. That is how the rule as above quoted came to be framed.

108. Life Insurance companies have continued to press their claim to complete exclusion of the bonus amount. They maintain that in 1939 the Government recognised the reasonableness of their claim, but declined to accede to it fully only for fear of its repercussions on the revenue. In their latest representations and during the interview with us, they have further urged that the financial position of these companies has of late been so adversely affected that the considerations of revenue interest which prevailed in 1939 should no longer be allowed to stand in the way of doing justice to these concerns. In particular, they insisted that the fall during recent years in the rate of interest allowed on Government securities and other approved securities has led to a serious diminution of their income, while the Insurance Act compels them to invest more than one-half of their funds in Government securities or other approved securities. They also pointed out that in recent years working expenses have very greatly increased with a resultant diminution in profits. They maintained that under present conditions many insurance companies found it hard to fulfil their obligations to policy-holders whose rates of premia had been fixed under more favourable conditions but whose policies have still many years to run. They also stated [illegible] they were no longer able to pay bonus at anything like the [illegible] to pay formerly and in many instances the percentage of bonus was even likely to be lower or at best a little more than the load levied in respect of participating policies. As regards the alternative method of assessing the tax on the basis of the investment income, they complained that it was not fair to allow a deduction only in respect of a portion of the actual expenses—as is now being done—but that the whole expenses should be allowed as a proper deduction. This claim too was supported on the ground that such was the practice in England.

109. Taking up first the valuation surplus basis method of assessment, we may point out that many of the arguments now urged in support of the claim for full deduction of the bonus amount have been considered by the Ayers Committee; but we think that there is some force in the contention that that Committee did not realise the full force of the argument. Whether the Government in accepting the 50-50 basis only accepted it on grounds of expediency and as a compromise or recognised that the Committee's recommendation was not well-founded in reason, is more than we can say. We are, however, inclined too think that the logic of the claim for *full* exclusion of the bonus amount is not altogether unassailable.

110. Comparing the holder of a participating policy with a non-participating holder, the latter is not represented as getting any return of his premium; why then should it be said that the *whole* of the bonus paid to the participating holder is a return of excess premium irrespective of the relation which the

bonus may bear to the load? From the figures placed before us, we found that in some years a policy-holder had been paid a bonus of anything between 10 and 20 rupees per thousand per annum when his premium showed only a load of eight rupees per thousand per annum. Analysing these figures, it may not be incorrect to conclude that the bonus really consists of two parts and that it may be described as partly a return *of* the capital or premium and partly a return *on* the capital. This is probably the reason why the Royal Commission of 1920 guardedly observed that the actuarial surplus contained *elements* which cannot be fairly regarded as being within the scope of the Income-tax (para 514 of the Report). It is, however, true that the figure which represents the return *on* the capital has shown signs of substantial reduction in recent years as the result of a fall of interest on investments. In some instances, it was pointed out that the margin between the load and the bonus was very small. So long at any rate as the bonus amount was not less than twice the load, the 50-50 formula would have been quite justifiable both in theory and as a matter of fairness; but, if the tendency for the bonus amount to approximate more and more to the load should persist, the claim that a greater proportion, if not the whole of the bonus, would really be in the nature of return of the excess premium would be more and more justified.

111. In the report of the Ayers Committee, an argument has been urged that what is paid to the policy-holder is the result of a joint investment of the shareholders' capital and of the policy-holders' premia payments and that as the income is derived from such joint investment it is only fair that the shareholder and the recipient of the bonus should submit to tax in proportionate shares. But this argument if pushed to its logical length may place the recipient of the bonus in a worse position than a share-holder, because the shareholder will at least get the benefit of section 49-B of the Income-tax Act so as to secure a refund to him in cases in which his total income does not attract the five annas rate of tax. It was pointed out with some force by the representatives of the Insurance Companies that in investing the fund which is contributed by a number of policy-holders, the insurance company merely acts as the agent of the policy-holders and that as such agent or trustee it is bound to pay over to the policy-holders their contributions as well as the interest earned thereon, so that it cannot be said that the insurance *company makes any profit at all* out of the transaction and that it is only the policy-holder that in the last analysis must be regarded as taxable if at all. If the distinction between the share-holder's position and the policy-holder's position is kept in view, there is much to be said in support of the claim that under present conditions a much greater portion than 50 per cent of the bonus paid to policy-holders should be excluded from computation. We do not, however, find ourselves in a position to fix any definite proportion if the 50-50 rule is to be departed from. The representatives of the insurance companies have this advantage, that they argue that if the English system is to be followed here, let us follow it as it is in England, *viz.*, exclude the *whole* of the bonus from computation. But we do not feel satisfied that the logic of the situation necessarily requires the adoption of that course. At this stage, the matter becomes largely one of fairness and expediency; and from that angle, it may not be right to exclude all consideration of the repercussions of any modification of the existing practice on the revenue. Taking the principle to be that so much of the bonus as is in excess of the load is in the nature of profit and taxable as such, we are of the opinion that tax should be assessed on the aggregate of (i) the dividends paid or reserved for share-holders and (ii) so much of the bonus allotted to or allocated for the policy-holders as is in excess of the sum representing the load provided for in the premia paid by the participating policy-holders. Another form in which the method may be defined is that the tax should be assessed on the total surplus (actuarial surplus and tax deducted at source) *minus* the sum representing the load. We realise that neither of these formulae will

admit of being stated in terms that can be easily applied and that their application may lead to different results in different companies. We must admit that even with Mr. Vythianathan's assistance we could evolve nothing better. Perhaps the Central Board of Revenue and the Insurance Department may in consultation with the Insurance Companies find a more easily workable formula giving effect to the principle above indicated.

112. A general argument was advanced that the insurance habit has not yet taken sufficient root in this country and that every encouragement should be offered both to the public and to the insurance companies to develop that line of business. While accepting the force of this argument, we must point out that such encouragement is offered in a large measure even by the existing law in so far as it exempts insurance premia to the extent of one-sixth of a man's income or Rs. 6,000, whichever is lower, from income-tax. Mr. Vaidyanathan suggested that this limit should be raised. We are not satisfied that it will be in the long-term interest of public—especially of middle class people—to hold out a temptation to put by more than one sixth of a man's income by way of insurance premia. A certain amount of consideration to insurance companies is also shown by the practice of exempting such companies from corporation tax. The addition which a person receives when he draws his policy amount, that is the excess over his premium contribution, is also exempted from income-tax, though it includes accumulated interest. Whether further encouragement is possible or is even necessary is a matter on which Government must come to its own decision and we do not feel that there is justification for our recommending any further measure in that behalf.

113. As regards the alternative of assessment on the investment income basis, we think that the claim that the entirety of the management expenses should be allowed as a deduction is theoretically justifiable. In explanation of the present restriction it was stated that this was imposed with a view to checking the tendency, prevailing at one time, to extravagance in incurring management charges. We were assured—and from what we know of the rising scales of salaries in recent years we can well believe—that there is not much room for extravagance in these days. Sir Purushothamdas Thakurdas suggested that the following modification of the existing rule will meet the present situation while also safeguarding against possible extravagance, namely, in rule 2 (d) of the Schedule to the Income-tax Act, the figure 15 be substituted for the figure 12. We commend this suggestion. This will mean that as regards renewal premium, the allowance for expenses will be 15 per cent of such premium instead of 12 per cent as at present. The rest of the rule, *viz.*, that relating to 90 per cent of the first year's premium where the premium-paying period of the policy is 12 years or more and 7½ of the first year's premium multiplied by the number of years for which premiums are payable, where the premium paying period is less than 12 years, will stand.

114. The next objection was to the present method of grossing up. It was complained that Income-tax authorities in India ignore the exemption of 50 per cent. of the bonus amount from tax when they insist on adding back to the taxable surplus the entire tax deducted at source, including that relating to the policy-holders' bonus item. The situation which has given rise to this problem results from the fact that a great portion of the income of life assurance companies is derived from interest on securities and dividends. As a matter of practice, the concerns which have to pay interest and dividends deduct income-tax before making payment or themselves pay the income-tax on the dividends. When the Actuary comes to make the valuation, he takes only the *net* income as the basis with reference to which the distributable surplus has to be declared. It is argued that this is not strictly a case where tax is payable on interest *qua*

interest because *exhypothesi* we are dealing with the case as one where the assessment is on the valuation surplus basis. The deduction of tax at source must, therefore, be regarded only as a matter of convenience and should not be allowed to affect the legal rights or liabilities either of the Government or of the company. If no deduction at source had been made, the surplus profits available for distribution would include the amount of tax deducted at source as well. If the 90 per cent is to be deducted therefrom as representing the share payable to policy-holders as bonus, it is argued that even on the present 50-50 rule of exemption, income-tax should be subsequently calculated only on the 10 per cent distributed to the shareholders and the 45 per cent representing one-half of the 90 per cent distributed to the policy-holders. After income-tax has been so arrived at, that amount may no doubt be grossed up with the taxable portion of the surplus and the ultimate tax leviable thereon may be set off against the tax which has already been deducted at source. The following illustrations will explain the difference between the several possible processes of grossing up:—

115. For illustration we shall take the statement of income on the basis of actuarial valuation surplus for 1947-48 of a well-known insurance company.

		Rs.	Rs.
Surplus as per Valuation Report for the Triennium ended 31st December 1945			1,76,77,107
Add (as per Rule 2(b) of the Schedule)—			
Income-tax deducted at source		1,01,04,462	
Depreciation on Furniture, Machinery, &c.		2,15,941	
Charitable Donations		93,655	
			1,04,14,058
			2,80,91,165
Deduct:			
Refund of Income-tax and Super-tax		7,61,297	
Unclaimed Dividends and Bonus Dividends forfeited		5,625	
			7,66,922
			2,73,24,243
Deduct: (as per Rule 3 (a) of the Schedule) — One half of the amounts paid to or reserved for or expended on behalf of Policyholders.			
Bonus to Policyholders		1,59,55,925	
Interim Bonus paid		5,91,424	
	½ of	1,65,47,349	82,73,675
			1,90,50,568
Deduct: Interest on Mysore Government Securities			1,23,847
Surplus for three years			1,89,26,721
Annual Average			63,08,907
Deduct: Depreciation as per separate statement			1,06,568
			62,02,339

116. Shorn of details which are unnecessary for our present purpose, the taxable income in round figures is arrived at as follows under the method at present adopted by the Department, which may be referred to as 'A'.

A

	Lakhs
Surplus as per Valuation Report for Triennium ended 31-12-1945 . .	1,76
Income-tax deducted at source	1,01

The taxable income is arrived at as follows
Surplus—176 lakhs.

of which 90%, *i.e.*, 158·4 lakhs goes to Policy-holders and 10%, *i.e.*, 17·6 lakhs to Shareholders.
Out of 158·4 lakhs, 50%, *i.e.*, 79·2 lakhs is allowed as a deduction for the purpose of calculating tax.

Therefore Taxable income is	176 lakhs
	—79·2 lakhs
	96.8 lakhs
Add the tax deducted at source . . .	101 lakhs
Therefore Taxable income for the Triennium is	197.8 lakhs
Annual average	65·93 lakhs

117. Another method—under which the policy-holders' share of the bonus which is allowed as a deduction should not be grossed up. would yield the taxable income as follows:—

B

	Lakhs
Surplus	176
Less half of 90% allowed to Policy-holders	79·2
Taxable surplus	96·8
Grossing up at 5 annas in a rupee .	
Taxable income for the Triennium .	140·8
Annual average	46·9

118. A third method by which the taxable income can be arrived at after taking into account the condition that half the policy-holders' bonus is to be excluded in computing taxable profits is the following:—

	(In lakhs) Rs.
Surplus after valuation .	176
Add Tax deducted at source	101
	277

As the net amount that could be paid to policy-holders can be ascertained only after provision has been made for the payment of tax on the taxable portion of the policy-holders' bonus, we shall refer to it for the present as 'Y'. Assuming that shareholders and policy-holders share the gross distributable

amount in the proportion of 1: 9, the figures will stand as follows in lakhs of rupees:—

Policy-holders' share in the distributable amount	Policy-helders' share liable to taxation on the basis of 50:50	Rate of tax	Net amount paid to the policy-holder
$277 \times \frac{9}{10}$	$-\left(277 \times \frac{9}{10} - \frac{Y}{2}\right)+$	$\frac{5}{16}$	=
that is, 249·3	$-\left(\frac{498\cdot 6 - Y}{2}\right)+$	$\frac{5}{16}$	= Y
i.e. 249.3	$-\left(\frac{2493 - 5Y}{32}\right)$		= Y
	32		
i.e. 249·3×32	— 2493 + 5Y		= 32Y
i.e. 7977·6	— 2493		= 27Y
i.e.; 5484 6			= 27Y

∴ Y = 203·13 (lakhs)

The distribution of the 277 lakhs of Rupees will then be made as follows:—

	(In lakhs)
The policy-holders	Rs. 203·13
Tax payable on 277 — $\frac{203\cdot 13}{2}$ = 175·45 lakhs, @ 5 annas in the Rupee will be	Rs. 54·83
Net amount which will be payable to shareholders, as their share of the surplus will be	19 04
Total	Rs. 277 lakhs

This last method seems to us more logical than the method *B* which, we think, was the one suggested by the Association and the method *A* which, we believe, is now followed. Strictly speaking, there is no grossing up, because Rs. 101 lakhs is not the tax deducted at source on the net surplus of Rs. 176 lakhs. It also includes the tax on that part of the investment income which has gone into the Life Fund. After setting aside what the actuary considers to be the sum necessary for the Life Fund to meet its liabilities, the entire balance, namely, Rs. 176 lakhs *plus* Rs. 101 lakhs *minus* the tax actually payable, will be the distributable surplus. Comparing the figures above set out with those found in the method we have marked "A", the position will stand as follows:—

Since the policy-holders have got only Rs. 158 4 lakhs (under "A") and not Rs. 203·13 lakhs, the balance of Rs. 44·73 lakhs to their credit in the refund (*which has borne the tax*) will be available for distribution to them at the next valuation without tax because it has already borne tax. Similarly, as the shareholders have got only Rs. 17·6 lakhs and not Rs. 19·4 lakhs, the balance of Rs. 1·44 lakhs to their credit must be available to them for distribution at the next valuation without tax because it has already borne tax. Tax refundable will be Rs. 101 lakhs *minus* Rs. 54·83 lakhs, that is, Rs. 46·17 lakhs, of which, as above explained, Rs. 44·73 lakhs is the policy-holders' portion and Rs. 1·44 lakhs of rupees is the shareholders' portion.

119. For the reasons that we have above explained, it seems to us that the fact of deduction at source cannot affect the legitimate method of calculating the surplus available for distribution, nor should it be allowed to nullify the effect of the rule which exempts one-half of the policy-holders' bonus from liability to tax. In this view, the present method of grossing up seems to us difficult to accept as the proper method.

120. In justification, or at any rate in explanation, of the method now obtaining, it was stated that the declaration of the distributable surplus is the duty of the Actuary who makes the valuation and that the Income-tax Department only accepts what he has declared and assesses the company on that basis. We are not attempting to apportion the blame between the Actuary and the Department. We, however, feel that if the method adopted by the Actuary is not the correct method, it is only fair that we should indicate what in our opinion the correct method would be.

121. To avoid all these difficulties and for other reasons as well, it was suggested that the practice of deducting tax at source may be discontinued so far as the interest and dividends payable to life-assurance companies are concerned. We are not prepared to go so far. Even if the case does not strictly fall under section 18, it must at least fall under section 18-A and instead of adopting the method indicated in section 18-A, it will probably be more convenient to continue the practice of deduction at source. The difference the two methods will practically resolve itself into the question of right to or liability for interest. In the circumstances, we think that justice will be done to the insurance companies if Government would allow them interest at two per cent. per annum on the amount by which the amount deducted at source (or, in the case of dividends, the amount paid by the company concerned, on behalf of the Insurance Company), may exceed the amount of tax actually levied on the Insurance Company.

122. The last point pressed related to the rate of tax to be levied on Insurance companies. It was suggested that even the five annas rate is too onerous and that it should be reduced to the 45 pies rate which was in force in the year 1940-41. We see no justification for this kind of discrimination in favour of this class of companies. Even as it is, they are better off than other companies in that they do not pay the two annas corporation tax. It may indeed be a question whether logically so much at least of the income of life insurance companies as corresponds to the portion distributed amongst its shareholders should not be treated as standing on the same footing as profits made by any other company with the consequent liability to bear the two annas corporation tax. Whatever justification for special treatment may be founded on the character of life insurance companies has been attempted to be met by adjusting the method of determining their assessable income and it does not seem necessary to fix a special rate for their taxation.

123. One or two other points were touched on in the course of the interview, but as they were not seriously pressed, we do not think it necessary to say much about them. One such suggestion was that when tax was deducted at source, credit for the amount deducted might be given in the *succeeding year.* Taking long periods, we do not see how this change will make much difference. Further, the assessable income is not, in fact, determined for each year, but is only taken as an average based on the triennial or quinquennial valuation We, therefore, leave this matter as it is. We may add that in the course of the discussion the representatives of the Insurance companies seemed to think that the system of taxation in vogue under the Australian Income-tax Act and in the U.S.A. was more consonant with the theory of taxation that should apply to Insurance Companies than either of the alternatives recognised by the Indian law; but, there was little more than a passing indication of their preference; neither they nor we have any data with reference to which we can determine the comparative result of the operation of the several methods of taxation.

124. Before passing on to the next topic, it seems to us necessary to say a few words on the law relating to taxation of mutual insurance associations. Prior to 1939, mutual insurance companies were not taxed in India on the basis of "profits" apparently in accordance with the decision of the House of Lords in *Styles' case* (Law Reports 14 A.C. 381). Authoritative decisions introduced some refinements into the English rule and in 1933 Parliament [by section 31(1) of the Finance Act. of that year] enacted that "profit or surplus arising from transactions of the company or society with its members" would be taxable as "profits or gains" in all cases where they would have been taxable as such "if those transactions were transactions with non-members." This lead was followed by the Indian Legislature in the legislation of 1939. The new definition of "income" (section 2, sub-clause 6C) was made to include "the profits of any business of insurance carried on by a mutual insurance association computed in accordance with Rule 9 in the Schedule" and Rule 9 provided that the preceding rules (1 to 8) apply to the assessment of the profits of any business of insurance carried on by a mutual insurance association. This rule reproduces in effect the concluding words of section 31, sub section (1), of the English Finance Act, 1933.

125. The operation of the above provision in the English Finance Act has practically been nullified so far as mutual insurance companies are concerned, by the decision of the House of Lords in *Inland Revenue Commissioners* v. *Ayrshire Employers Mutual Insurance Association, Ltd.*, 1948 *I.T.R. Supp.* 80. Relying on the exposition given in *Municipal Mutual Insurance* v *Hill*—16 Tax Cases 430—as to the basis and effect of the decision in Styles' case, the House of Lords emphasised the distinction between "surplus" and "profits" and held that "the surplus was not profit within the meaning of the Income-tax Acts but merely represented the extent to which the contributions of those participating in the scheme had proved in experience to have been more than was necessary to meet their liabilities. The balance or surplus was the contributors' own money and returnable to them." Referring to section 31(1) of the Finance Act, 1933, Lord Macmillan said that the hypothesis on which the section rested was wrong and that "the Legislature has plainly missed fire." Even the intended purpose of the legislation was characterised by him as "not the meritorious object of preventing evasion of taxation but the less laudable design of subjecting to tax as profit what the law has consistently and emphatically declared not to be profit." In the recent judgment of the Privy Council in *English and Scottish Joint Co-operative Wholesale Society, Ltd.* v. *Commissioner of Income-tax, Assam*—1948 2 M.L.J. 242—the basis of the decisions relating to mutual insurance companies has been explained in the same manner as in the Ayrshire Employers Insurance case.

126. The criticism in the latest judgment of the House of Lords against section 31, clause (1) of the English Finance Act of 1933 may well be applied to the effort of the Indian Legislature to subject mutual life insurance associations to income-tax. Government must make up its mind whether it is going to treat mutual insurance transactions as transactions yielding profits. If it so decides, it must specifically use charging *words* to make the *surplus* arising from such transactions liable to tax, or as has been done in section 53, sub-section (2), paragraph (h) of the Finance Act, 1920, relating to Corporation Profits Tax, income must be declared to include, in the case of mutual insurance companies, the surplus arising from transactions with members. As the Indian law now stands, rule 9 of the Schedule is not a charging provision but only prescribes a method of computation. The charge must be derived *by implication* from the definition of "income" but that definition only brings in "profits" of the mutual insurance business. The definition is based on the assumption that the surplus can be regarded as profits in such a case and it is

this assumption that has been declared by the House of Lords to be wrong. This criticism may not probably apply to the taxation of the investment income of the company as *interest* and not as profits.

G.—Religious and Charitable Trusts.

127. Three questions have been raised with reference to the assessment of income derived from properties set apart or businesses conducted for the benefit of religious and charitable trusts, *viz.* (i) whether the exemption under section 4, sub-section (3), clause (i), in favour of such trusts will be available to cases in which the purposes of the trust do not substantially relate to anything to be done within this country; (ii) whether on the analogy of section 16(1)(c) even settlements in favour of charitable or religious purposes should not be ignored for purposes of income-tax if such settlements are revocable; (iii) whether the exemption conferred by section 4(3)(i)(a) in respect of income derived from business carried on on behalf of a religious or charitable institution could in effect be extended by holding such business to be "property" within the meaning of clause (i) of that section. The first of these questions arises out of an answer given by the then Finance Minister to a question in the Legislature in respect of income derived in this country by the Oxford University Press. The answer assumed that though such income was not utilized for any charitable purpose within India itself, it was nevertheless exempt from income-tax because section 4 (3) (i) was not limited territorially. It seems to us that even on the provision as it stands, a different view might well have been taken on the strength of the observations of Lord Hobhouse in *Webb* v. *England*—Law Reports 1898 A.C. 758. Dealing with the exemption under section 7 (e) of the Victorian Income-tax Act of 1895, of income derived by all trusts, societies, associations, institutions and public bodies, not carrying on any trade for the purpose of gain to be divided among the shareholders or members thereof, Lord Hobhouse said "Another point of much more importance was raised in the course of the argument and discussed at the Bar, though it does not seem to have been raised in the Court below, and that is whether the trusts, etc., mentioned in head (e) mean trusts, etc., not operating in Victoria. It seems very strange that the Victorian Parliament should desire to forego income-tax in favour of a Scottish institution which has no connexion with Victoria except in its character of a property owner there." Referring to certain other heads in the same context, he pointed out "It can hardly be that the Parliament of Victoria has such great regard for social and industrial combinations and efforts all over the world that it should offer to the Jesuits' Society in Rome........... Athenaeum Club in England . . . . exemption from income-tax if they choose to invest their funds in Victorian land..... It seems to *them* much more reasonable to suppose that in framing heads (c), (d) and (h) the Legislature was speaking of bodies acting in or for Victoria. And the same reason applies to the head (e)." Ratcliffe and McGrath in their Law of Income-tax in Australia treat the case as one where the exemption must be read as subject to a territorial limitation *although not expressed in the Act*. It would also appear from the observation in Plaxton's Canadian Income-tax Law (at page 73) that he too understood the above observations of the Judicial Committee as justifying the following proposition:—"The exception in favour of the institutions enumerated is only applicable, it would seem, where the excepted object is pursued within Canada and an institution carrying out its objects outside of Canada but deriving income from within Canada is not entitled to exemption." We would, however, add that if this view commends itself to Government, the same may be enacted clearly by the addition of the necessary words to section 4 sub-section (3), clause (i).

128. The second question, *viz.*, that relating to revocable trusts for religious or charitable purposes arises in consequence of a recent decision of the Bombay High Court in Income-tax Reference No. 6 of 1946 decided on 11-3-1948 (not yet reported). In that case, the Department attempted to maintain that the language of section 16(1)(c) of the Income-tax Act should be held to apply to religious or charitable trusts as well wherever such trusts reserved a power of revocation to the settlor. The Learned Judges pointed out that section 2, clause (15), excluded from the operation of the Act income to which under sub-section (3) of section 4 the Act did not apply and as section 4, sub-section (3), clause (i) did not draw any distinction between revocable and irrevocable trusts, it was not possible to bring religious or charitable trusts within the operation of section 16 (1) (c). On the language of the sections as they stand, this conclusion seems to us unexceptionable. Section 16 (1) (c) was the result of a compromise formula reached during the debate in the legislature on the amending Bill of 1938 and we are not in a position to assume whether or not it was the intention at the time to include even religious or charitable trusts within the policy of section 16 (1) (c). The recommendation of the Ayers Committee which led to the enactment of that provision has not made any specific reference to this point. We are, therefore, unable to say whether the position taken up by the Department in the recent Bombay case really represented the intention of Government.

129. On the one hand, it might be said that the policy underlying section 4 (3) (i) justifies the exemption even in the case of revocable trusts, so long as the religious or charitable trusts are in force. On the other hand, it is equally possible to maintain that under color of such a document many frauds may be committed, because not only are the Income-tax authorities unable to examine the actual execution of the trusts, but even the probability of outsiders interested in the religious or charitable purposes enforcing their performance is greatly reduced in such cases, they may hesitate to take any legal proceedings to enforce the proper observance of the trusts, because the trusts may at any time be revoked by the settlor. In view of these potentialities for fraud on the trusts and fraud on the Income-tax law, it is for the Government to decide whether the principle of section 16 (1) (c) in so far as it relates to revocable trusts should be applied even to trusts for religious or charitable purposes. If it is decided so to apply, section 4 (3) (i) may have to be qualified by a reference to and by subjecting it to section 16 (1) (c). This itself will introduce the same limitation in section 2 (15); but to place the matter beyond doubt, the reference to section 16 (1) (c) may be repeated in section 2 (15) also.

130. The third question arises out of a decision of the Lahore High Court in *Gadodia Swadeshi Stores case*—1944 I.T.R. 385. It was there held that the trustees of an educational institution who purchased a store and carried on business and earned profits were entitled to the benefit of the exemption under section 4 (3) (i), though if the case had fallen to be decided with reference to section 4 (3) (ia), they would not have been entitled to the exemption, because the business was not carried on in the course of the carrying out of the primary purpose of the institution or by the beneficiaries of the institution. The Learned Judges took the view that the "business" was nonetheless "property" within the meaning of section 4 (3) (i) and as the limiting conditions attached to section 4 (3) (ia) did not govern section 4 (3) (i), they allowed the trustees the exemption claimed. This view seems to us hardly consistent with the intention with which section 4 (3) (ia) was inserted in the legislation of 1939, though it is perhaps justifiable on the language of the clauses as they stand. It has been pointed out that if clause (ia), had been intended to be an exception to clause (i), it should have been expressed as a proviso and not as a mere additional concession. The Learned Judges of the Lahore High

Court also laid stress upon the wide significance of the word "property", but undue stress upon the significance of that word would hardly give effect to the juxtaposition of the two clauses.

131. It is clear from the report of the Ayers Committee which recommended the insertion of clause (ia) in section 4 (3) that they really intended this clause as a restriction on section 4 (3) (i). After referring to the wide significance of the word "property", they observed "If, however, any limitation is desired, we suggest......that business carried on by the trustees of a religious or charitable trust should be exempt only when the business activities are in themselves the primary purpose of the charity or when the work in connection with the business is mainly carried on by the beneficiaries". It is this language that has been adopted in framing the new clause. In making that recommendation, the Ayers Committee referred as a parallel to section 24 of the English Finance Act, 1927, from which their language has obviously been borrowed. In that context, "property" and "business" were clearly distinguishable from each other, because section 30 of the Finance Act of 1921 into which the new exemption was inserted referred to the several Schedules of the English Income-tax Act dealing respectively with lands and business and the provision now under discussion was made in respect of Schedule D. It is clear from that provision that the limiting words were regarded as a necessary condition of the exemption in favour of a business carried on by or for the benefit of a charity. The restricted interpretation is also justified by the argument that it would be unfair to other businessmen who may carry on the same business if they should be subjected to income-tax in respect of their business income while charities who compete with them in business independent of their particular line of work should be exempted from tax. It seems to us best to remove all ambiguity in the matter by making it clear that section 4 (3) (ia) is to be regarded as a proviso to section 4 (3) (i).

H.—Collection and Information at source.

(Question 12)

132. Deduction at source will be one of the best ways of reducing the opportunities for evasion of payment of tax; but in the circumstances of this country, there are obvious limitations to the application of this method. Except where the person who makes the deduction can be safely relied upon to pay over the deducted tax to the Government or can easily be singled out if he makes default, the provision for deduction at source will be of little advantage. Again, deduction at source to any large extent may greatly add to the number of claims for refunds and this part of the Department's work has already come in for so much criticism that we hesitate to add to it unless the advantage distinctly outweighs the disadvantage. Nearly all the replies to our Questionnaire have expressed the view that for the present at any rate, the existing provisions authorizing or compelling deduction at source cannot be expanded.

133. The next best course is at least to extend the cases in which information must be furnished to the Department. But many of the replies have complained that the information even now furnished under sections 19-A and 20-A is not wholly or properly utilized by the Department. We cannot say that there is no justification for this complaint; but, as we are making recommendations for improving the machinery which can utilise the information made available to the Department, we are also suggesting a few directions in which the provisions relating to the giving of information to the Department by persons making payments may be extended.

134. Sections 19-A and 20-A are very limited in their scope and information under section 38 (3) will be available only from the assessee and that too only on requisition from the Income-tax Officer. Two improvements seem possible and necessary: (1) the obligation to give verified information *on requisition* may be imposed on *any* person who may be assumed or suspected to have made payments of rent, premium, interest, commission, royalty, brokerage, annuity, etc; it does not seem necessary to compel resort to section 37 for this purpose. (2) a statutory obligation may be cast on persons making payments of *Rs. 1,000 or more per annum by way of taxable rent, premium, commission, royalty, brokerage, annuity, etc., *voluntarily* to furnish information of such payment to the nearest Income-tax Officer. As a sample of the kind of provision that may be made in this behalf, we may refer to section 39, sub-section (5) of the Canadian Income-tax Act and to sections 147 and 149 of the U.S.A. Internal Revenue Code. If the collating organisation is made efficient, the lower limit of Rs. 5,000 fixed by Rule 42 (for returns to be furnished under section 19-A in respect of dividends paid by companies) may be reduced to Rs. 2,000 (if not Rs. 1,000). Where dividends are collected by Banks (as sometimes happens) as representing shareholders whose names are not disclosed, either the companies may be asked to ascertain or the Banks may be asked to disclose the names of the shareholders on whose behalf the dividends are collected. It may also be useful to enact a provision that persons doing business in India on behalf of non-residents or in respect of goods sent to India for sale by non-residents should report the fact of such business to the Income-tax authorities and also give them the name or names of the non-residents on whose behalf they are doing business or whose goods have been sent to them for sale

I.—Advance Payments and Interest Thereon

(Question 14)

135. Section 18-A was introduced during the war and was represented as an anti-inflationary measure Business interests have been pressing for its repeal. Circumstances existing today are certainly no better than they were during the war. We are, therefore, unable to make any recommendation in favour of the repeal of the provision. It would appear that in the United Kingdom the corresponding provision is undergoing substantial changes; but we do not have detailed information before us in respect of these changes. We think it right to refer here to a suggestion made by Khan Bahadur J. B. Vachha, C.I.E. His long experience and intimate knowledge of the working of the Income-tax Department justify a careful consideration of the suggestion. He would substitute in place of section 18-A a provision requiring "payment on accrued income as computed by the assessee himself while putting in his return of income". This suggestion has been supported in some of the other replies to our question. This course will have this advantage that it will secure payment of the revenue without waiting for the completion of the assessment, but it will also relieve the taxpayer from liability to pay the tax even *before* the profit of the business can be definitely predicated. It is further claimed that this will save the officers of the Department the time and trouble now spent on issuing notices under section 18-A. As things stand today, with many assessments being in arrears for several years, the standard mentioned in section 18-A, viz., the income-tax and super-tax payable on so much of such income as is included in his total income of the *latest previous*

*Rs. 1000 will be too low a minimum for the annual rent in big cities Power may therefore have to be vested in the C. B. R. to declare different minima of annual rent for different cities particularly cities like Bombay Calcutta Kanpur Ahmedabad etc.

year in respect of which he has been assessed is likely to prove a very unreliable test in many cases.

136. The Indian Chamber of Commerce, Calcutta, suggested an alternative provision on the following lines:—

"(a) A basic profit which shall not fall below say 50 per cent of the assessed profits. This shall be applicable irrespective of the advance payments being made whether on the basis of the previously completed assessments or own estimates. Penal provisions to be attracted only in cases where they fall short of 50 per cent.

(b) Due allowance to be shown for add-backs on technical grounds or for unrealised profits.

(c) A bonus system based in proportion to the excess of the profits for purposes of advance payment of tax over the basic profits be considered which may be as a rebate of tax or othe

(d) The minimum amount of profits prescribed attracting the penal provisions of section 18-A should in any case be raised to Rs. 12,000."

137. As the meaning and implications of the above proposals were not quite clear to us, we requested the Chamber to elucidate the same. The following extract from its reply throws further light on the proposal:—

"Though the object of the legislation has been to facilitate the taxpayer with easy instalment of tax, in many genuine cases the taxpayer is greatly handicapped and has to pay unnecessarily heavy amount of penalties The suggestions made in the memorandum therefore are that a 50 per cent accuracy of profit for the year must in any case be attempted. The 50 per cent basis may be based either on the last assessed income or on the assessee's estimate. This basic 50 per cent income must be subjected to advance payment of tax and carry interest at 2 per cent as at present. Any deficit in the figure must be subjected to penal interest at 6 per cent and to penalties also in the case of gross under-estimate or wilful negligence without any reasonable cause or excuse As an under-payment is subjected to heavy interest payment and penalties, it is necessary to induce the assessees to pay as high a figure as possible over the 50 per cent basic profit by giving some greater attraction than at present. It is therefore, suggested that payment in excess of this 50 per cent profit should be subjected to greater interest or some sort of a sliding scale bonus attractive enough to the assessee to make as high a payment as possible At present an uniform rate of 2 per cent interest is allowed on all amounts paid irrespective of accuracy of payment. This is not attractive. The interest paid should rise according to accuracy aimed at above 50 per cent by a suitable sliding scale say, 2 per cent for each 10 per cent of the excess over the basic figure of 50 per cent. If it be considered that this interest works a little too high as is suggested for greater accuracy a sliding scale of bonus based on accuracy by deduction from the tax payable be allowed."

We are not in a position to say how far the two alternatives above suggested will either simplify the work of the Department or meet the need which section 18-A was expected to provide. As the suggestions, however, seem worth examination, we have reproduced them.

138. Taking section 18-A as it stands, question 14 of the Questionnaire gives expression to one's first impression that there is perhaps no justification for allowing interest on advance payments under section 18-A without likewise allowing interest on deductions of tax under section 18. Many of the replies affirm that there is no justification for such a differentiation. On fuller consideration, however, we think that those who defend the differentiation are right. Section 18 deals with cases where the income has actually accrued to the party concerned and the liability to pay tax may also be considered to have arisen, whereas section 18-A deals with cases where profit has not actually accrued but is only expected to accrue. Objection has been taken in some of the replies to the provision which allows interest at only 2 per cent. on advance payments, while the subject is charged 6 per cent. under other sub-sections of the same section. The differentiation is not unreasonable. The object of the higher rate in the latter category of cases is to prevent the assessee from improperly under-estimating his liability when he pays on his own estimate. It is in his power to avoid this situation by acting on the notice issued to him by the Income-tax Officer.

139. There is, we think, more substance in another point raised in this connection. Owing to the delay that under present circumstances unavoidably takes place in completing the assessment of businessmen, the sums deposited by way of advance payment of tax remain unadjusted during all the time that the assessment is pending. It has been urged that in many instances businessmen have to borrow large sums for making deposits under section 18-A and that the two per cent. interest allowed on such deposits does not suffice to make good the loss of interest that they have to undergo. The hardship of this position is likely to be particularly felt during the next few years when payments under section 18-A may have to be made on the basis of fairly large profits made during the war years, though the profits may not be anything so high for the year in respect of which the advance payment is actually made. It has accordingly been claimed that as soon as an assessee files his return under section 22 [sub-section (1) or sub-section (2)], he should be permitted to claim refund of whatever he has paid under section 18-A in excess of what may be due as per his return. This seems to us impracticable because till the assessment is completed, the extent of refund cannot be finally determined. But, if the assessment is not completed, say, before the end of the assessment year, the assessee can legitimately complain that he should not be made to suffer for the delay of the Department. In this view, it seems to us right to allow interest to the assessee at least at four per cent. on the deposited amount from the close of the assessment year, except where the completion of the assessment before that date has been prevented by the conduct of the assessee.

J.—Deductions and Allowances

(Questions 18 to 21)

140. The points raised by these questions are more matters of detail than of principle. Question 18 relates to an item about which we have heard loud complaints. We wish we were able to accept the assurance given to us from some quarters that assessees may be trusted not to think of gaining a point by showing items of personal expenditure as business expenses. Cases have come to our notice where there was strong ground for the suspicion that the cost of personal requirements was deliberately included (under false descriptions) in bills relating to business expenditure. However, as we are anxious to see the relations between the Department and the assessees improved, we would recommend that Income-tax Officers may be instructed not to be unduly strict about the *amount* of expenditure under heads like motorcars maintained and

entertainments or other attractions and amenities provided for the benefit of customers, so long as they are satisfied that such amount was actually spent and that no attempt was continuously made to pass off private expenses as business expenses. It cannot be denied that in these days of competitive business, expenses have to be incurred on a more lavish scale than of old to attract and retain customers. There is much practical good sense in the following observation of a text-writer:—

> "Theoretically, only costs associated with the *earning* of income should be deductable; costs involved in spending this income for personal purposes should not enter the income concept . . . . occasionally the line cannot be clearly drawn between the two and tax laws are generous in allowing possible '*expenditure*' costs together with 'income' costs.........Unless general rules are modified by wide administrative discretion, they are certain to be arbitrary and do injustice in individual cases." (Shultz American Public Finance, 3rd Edition, p. 441).

141. Question 19 relates to attempts to show items of capital expenditure on plant, machinery and buildings as no more than cost of ordinary repairs and maintenance. We cannot say that the danger is imaginary or that it was merely a phenomenon of the war period, but the question involved is undoubtedly a question of fact. It may be sufficient to warn Income-tax Officers to be on their guard against such attempts and whenever they find that any claim under these heads is larger than may seem normal or reasonable for the particular concern, they may be instructed to examine the items themselves with the aid of experts and place on record for the guidance of future officers the results of their examination. Some replies have even gone the length of suggesting that photographs of the machinery and building in question may sometimes be taken and placed on record.

142. Question 20 relates to the claim to deduct interest paid on loans borrowed for business. There is of course no intention to interfere with the discretion of the assessee as to the necessity for or the prudence of the borrowing or even with the way in which he employs the borrowed money, so long as it is used in and for the business. The question was raised because the mere fact of a *purported* borrowing for business does not guarantee that the money is used in or for the business. To ensure this, some of the replies have suggested the addition of the words "and used" after "borrowed" in section 10(2)(iii); other replies have suggested the insertion of a condition that the loan should not be diverted to purposes not calculated to yield taxable income. Whichever of these suggestions be adopted, difficulties may arise in their application to cases where a person employs in his business both his own funds and borrowed funds. As the existing provision does not appear to have so far led to any large measure of evasion or leakage of revenue, we prefer to let the clause remain as it is.

143. The point raised by Question 21 has been dealt with in the Instructions recently issued by the Central Board of Revenue. We therefore say nothing more on this point.

K.—Stock Valuation

(Question 22)

144. The question of valuation of stocks arises in the computation of income. In everyday business, it is very seldom that a trader is able to sell every bit of the goods he purchases in a year. In computing the profit or loss, for the year, therefore, account has to be taken not only of the realisations by sale but also of the value of what remains on hand as stock, of the cost of purchases in the year and of the cost of materials brought over from a preceding year.

145. The problem of valuation of stock presents two facets:—(i) The quantum of the stock, and (ii) The rate at which the quantum is to be valued for the purposes of the Income-tax Act. The quantum of stock raises again the question as to what constitutes the stock to be valued. According to commercial practice, if the quantity of a commodity which is acquired by purchase is not fully sold off, the unsold balance is to be brought to account as trading stocks on hand in order to arrive at the profit earned on the year's transactions In the case of a manufacturer, the trading stocks include both finished and partly finished goods and "in the case of raw materials and supplies, only those which have been acquired for sale or which will physically become a part of merchandise intended for sale, in which class fall containers, such as kegs, bottles and cases, whether returnable or not, if title thereto will pass to the purchaser of the product to be sold therein" (Regulation 111 of Sec. 29.22 (c)-1, U.S.A. Code). A similar description of "trading stock" is to be found in Sec. 26 (4) of the U. K. Finance Act, 1938:—

"For the purposes of this Section, the expression 'trading stock' in relation to any trade means property of any description, whether real or personal, being either—

(a) property such as is sold in the ordinary course of the trade or would be so sold as if it were mature, if its preparation, manufacture or construction were complete,

(b) materials such as are used in the manufacture, preparation or construction of any such property as is referred to in the last fore going paragraph."

These trading stocks which remain on hand at the end of the year of account, *i.e.*, closing stocks, become at the beginning of the succeeding year to which they are carried over, the opening stocks for that year. The quantity of the opening stock cannot, therefore, differ from that of the corresponding closing stock for the earlier year. It is established law that trading stocks in the hands of the trader or manufacturer are what he legally owns and has the right to dispose of.

146. To arrive at the correct quantum of stock, at least two operations are necessary: first, to list the goods unsold as on the last date of the accounting period and, secondly, to check the correctness of such a list with reference to the goods owned and acquired during the accounting period and those disposed o in the same period. Without the second operation, the stock list is not accepted as having been proved correct. In certain trades and industry, such verification is not easy, either because an identifiable description of sales is not possible as in the retail trade or because as in a manufacturing industry the purchases being of raw materials and the sales being of goods manufactured out of them, a relative quantification of sales and purchases is difficult. For purposes of audit, in such cases, a certificate from the proprietor or manager is often accepted as sufficient proof of the correctness of stock brouhgt into account. Advantage is often taken by the Income-tax Department, it has been urged, of this difficulty in verifying the quantity of stock on hand, to reject accounts and to make heavy estimates of profits, even though the accounts present no other defects. On the other side, it is argued that the certificates by Managers are a poor substitute for verification and that particularly where the rates of taxation or measures of taxation vary from year to year, incomes have been manipulated by either understating or undervaluing stocks. It has, therefore, been suggested to us that some rules may be devised to ensure proper and correct ascertainment of stocks for the purpose of quantification of income. It has been suggested by some that it may be made compulsory on auditors to certify the correctness of the stock and not to rely on the certificate by the manager; and secondly, that the Income-tax authorities should be given power to check stock lists at or about the time of their preparation and to enter premises to satisfy themselves that the stock lists are

accurate. These suggestions are practicable only in the case of businesses which can and do maintain stock lists and whose stocks can be taken or checked without much difficulty. In the absence of any more workable proposal, we suggest that the proposal should be given a trial, if a provision can be made in the Companies Act accepting the first part of the proposal and in the Income-tax Act for the second part, subject to the limitation that the powers of the Income-tax Officer to enter premises should be exercised only after recording his reasons for taking the step.

147. Rules are meant to cure remediable defects. They cannot correct a defect which is inherent in a system. When, as before stated, the nature of the trade itself precludes a verifiable stock list, a set of rules cannot cure the defect. We see, therefore, no foolproof method by which stocks in a retail business can be verified and, after verification, can be accepted as correct. The acceptance of the stock list, if one is prepared by the assessee, must depend in such businesses in a large measure on the percentage of the profit disclosed by the businesses and how it compares with the general expectation of profits for a similar business in the same locality; and secondly, on the method of approach to the question by the Income-tax authorities. A generous allowance for the fluctuations in prices, and an accurate examination of the size of the sales and the purchases at each point of change in prices, will often narrow the difference between the estimates of the Income-tax Officer and of the assessee in such matters Where the nature of business is such that a standard rate of profit is uniformly applied on all purchases of each class and such classes can be identified in sales, the method prescribed and followed in the U.S.A. may, we think, be used with advantage, in Indian conditions, to arrive at stock valuation in the case of retail merchants, Departmental Stores, including Chemists and Druggists, dry goods stores, etc. The principle is first to increase the cost of the goods purchased by a trader by the standard percentage applied by him to such purchases to cover profit, expenses, etc. This brings the cost price on par with sale price. If there are no fluctuations in prices, then the realisations on sale have only to be deducted from this value and the balance would be the selling price of the goods on hand. Reducing this value again by the percentage added previously, will bring it down to the cost. If, however, there have been fluctuations in prices during the year and these fluctuations have forced a lower price, selling price has to be 'marked down' at a rate corresponding to the fall. This method can be roughly illustrated thus:

Goods cost		. Rs.	1,00,000
"Mark up" 50% of cost, to include 33/3/ for profit and the rest for selling expenses, etc.			50,000
			1,50,000
less Goods sold	50,000		
add mark downs	20,000		70,000
Selling price of goods on hand			80,000

By deducting from this total selling price, 33⅓ per cent., *viz.*, Rs. 26,667, closing inventory value is Rs. 52,333, which would represent cost.

148. There are obvious difficulties in prescribing this or similar method as a cure of the evil of all flat rate assessments. For one thing, the system presumes that a definite rate of profit is earned on the whole or on every item of a class of transanctions and that quantities can be determined for each quality of the goods sold. Without such a presumption, 'mark up' and 'mark down'

valuations which are to be made for quantities according to the price fluctuations will not be possible. Therefore, the system may not be workable in the case of extremely small retail traders. But it can be given a trial for assessments of large Departmental Stores, Chemists and Druggists, dry fruit merchants, etc., where the goods can be classified and a tabulation of quantities in the inventory of particular goods coming under the 'mark ups' or 'mark downs' can be made with some effort, and if given a fair trial in suitable cases, we think, it will give a dividend in goodwill from the public. An honest assessee will see in it a chance to prove his accounts, and it is quite possible that he will so arrange his affairs, if they are not already so arranged, as to make his selling price a definite increase over cost price, and the Department will gain by the improvement in his accounts. Although claiming these advantages for this method, we do not propose that it should be given the statutory authority of a rule but would recommend that it might be included in administrative instructions to assessing officers.

149 Under the approved methods of commercial accounting, stock might be valued (i) at cost price, (ii) at market price, or (iii) at either cost or market price, whichever is lower. The following quotation from Spicer and Pegler in 'Practical Auditing' page 170, expresses the accountants' view:—

> "Stock should be valued at cost or market price whichever is lower at the date of the Balance Sheet. In no case should the value be higher than cost, even though the market value has risen, as this would result in taking profit before the sale is effected and the profit earned. On the other hand, a fall in the market value, due to fluctuation in the price, need not be considered, if the value has since arisen. A permanent fall in the value, however, must be taken into account".

The same principles are accepted for stock valuation for the purposes of the income computation in most countries of the world. The cost price system is the easiest to appreciate. Its effect is to eliminate the goods on hand from the Trading Account and what is left being the realisation on sale and the cost to the trader of such sales, the difference between the two figures is the gross profit. The valuation at market price is defensible on the theory that the trader might as well sell the goods on his hands at the end of the year or retain them. If he were to sell the goods, he would realise only the market value and that, therefore, is the amount that should be brought into the account, for the purpose of computation of income. The limitation of the use of market price to the extent that it does not exceed the cost price is due not to any theory of income, but only to expediency. One commentator puts the argument bluntly as follows: "If appreciation were taken in valuation, the profit shown will be not only profit on goods sold, but also the supposed profit on goods unsold and on hand. While the former can be dealt with as such, the latter is contingent upon the sale in furture at the prices, which might or might not be actually realised......whereas it would be wrong to overestimate profit for its actual distribution would lead to depletion of capital and the eventual ruination of business, it would not be wrong to underestimate profit, for, at the most, it would lead to conserving the business resources" That this view is shared by the Courts is clear from the following quotation from *Hughes vs. Utting (B G) and Co. Ltd.* (1940 I.T.R. p. 57 Sup.): "The normal method of dealing with this item (i.e. asset unsold) would be to make it up by calculating cost or market value, whichever is lower, of the various assets represented. The one thing, which it would be obviously wrong to do would be to make up the item by putting on the assets its market value, if it exceeds cost; that would result in swelling the gross profit......by bringing in as part of the gross profit an unrealised profit". Another argument against

valuing stock on hand at the market price if it is higher than cost is stated as under: "If mere appreciation were held to be profit, profit will be deemed to be made by holding stock and not selling them".

150. There is nothing in the Indian Income-tax Act which either prescribes or supports the three pronged practice of stock valuation, nor has the practice the sanction of any provision in the Income-tax Acts in U. K., although in that country also, the practice has been in vogue without dispute for many years and has been supported by the Courts, as we find from the above quotation. The Australian Act has, however, a provision, section 28 (1) prescribing this method of stock valuation. The U. S. A. Revenue Code does not mention the pratice directly, but it brings it in indirectly, through section 22 (c) of that Code which leaves it to the Commissioner to prescribe such basis with the approval of the Secretary as will conform as nearly as may be to the best accounting practice in the trade as most clearly reflecting the income. Unlike the Indian Act, the American Code describes what is to be understood by the terms "cost price" and "market price". These, however, only reproduce general accounting principles and we do not think any useful purpose would be served by incorporating the definitions in the Income-tax Act.

151. The system of valuing stocks either at cost or market price, whichever is lower, rules out the other modes of valuation sometimes found in India, viz.,

(i) the valuation of the goods at one uniform rate irrespective of the fluctuations,

(ii) the valuation of the stocks at a rate reducing the cost or market rates but at certain percentage for margin of safety or as a reserve,

(iii) a valuation made at the discretion of the owner without any regular system and without reference either to cost or market price, etc.

152. In some of the replies received by us, complaint is made against the rigid application of the rule that no change should be permitted from the system of valuation of stock once employed. The objection in effect is based on the theory that a business man is the best judge of his own business and, even if he considers it necessary to value the stocks in one way in preference to another, Government does not lose in the long run, as what is taken out of one year must go into another some time. This argument, however, ignores the fundamental concept of income under the Income-tax Act, which is what accrues or arises or is received in any particular year. Any adjustment, in the interest of safety, or as precaution, which has the effect of transferring any part of the income of one year into another, therefore, violates this concept and is inadmissible under the Act, nor is it correct to say that Revenue would not suffer in the long run. Revenue would suffer if the rates of tax vary from one year to another or if taxation like the Excess Profits Tax is levied for a limited period of years only. It might affect privileges, which, as in the case of voting power, depend on the payment of tax for a particular year. The Income-tax administrations in most countries, therefore, insist that once one method is selected—whether cost or market price or the lower of the two—for valuing the stocks—the same method must be consistently followed from year to year, a change being permissible only with the approval of the tax authorities. This is not expressly provided in the Indian Act, but section 13 provides that income profits and gains shall be computed in accordance with the method of accounting regularly employed by the assessee. A "method regularly employed" would normally include the method of valuation of stocks also. The Courts have supported the view that a method of valuation once employed cannot be changed to suit the convenience of the assessee. Thus, in *Re Chouthmull Golapchand* (1938 I.T.R. 733) the Calcutta High Court has held (at page 745)

that an assessee cannot change over to market price having in all preceding years valued the stock at cost price. Similarly in England, although there is no express provision to that effect, the Courts have supported consistency in the system of valuation of stocks. In the U.S.A., Regulation 111 under Section 29-22(c)—2 of the Internal Revenue Code as amended by T.D. 5423, I.R.B. 1945/1.37. makes the following recommendation:

> "Inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations."

It is, however, open to the Commissioner to allow a change being made if an application is made to him for permission within 90 days after the beginning of the taxable year at the end of which the inventory method is to be changed.

153. In view of the fact that Section 13 of the Indian Act is sufficient authority for insisting on proper and consistent valuation of stock, we are not in favour of introducing any Rules of the kind enacted in the U.S.A. We think such provisions might fetter the discretion now enjoyed by the Income-tax authorities to make exceptions in deserving cases. Thus, when goods are damaged by fire, floods or other natural causes, we understand that it is the practice of Income-tax authorities to allow the trader to reduce the value of stock to even below the cost or market, on the view that there is neither cost nor market value for damaged goods, their quality having been changed by the damage. Again, when there is an increment of the stock as, for instance, in the case of a stock dealer by the issue of bonus shares, although no actual expenditure is incurred on such increment the stock including the bonus shares are, we think, rightly valued at the average for the total of the original and bonus shares.

154. Reference has been made in some replies to the 'first in first out' method of valuation. When prices fluctuate violently, it becomes difficult to ascertain the cost of the individual blocks of purchases during the year. It has been, therefore, the practice to assume that the stock first purchased is the one first sold or used and the stock to be inventoried will be that which was last acquired. In valuing an inventory on the basis of cost or market, whichever is lower, the cost of any item by whichever method it is determined, is compared with its market price and the lower of the two is used. It has been objected to by some that when prices are mounting with an inevitable drop to follow, such a system is apt to inflate the profits for the year. It is suggested, therefore, that "stocks should take into account not only price changes but also the change in the volume of stocks and that any appreciation in the value of the original volume should be excluded from profits". We do not approve of this suggestion, which amounts to keeping off the accounts the profits attributable to the "previous year" on the anticipation of a drop in prices at a future date. Considerations like anticipated value or a "cushion" would, as we have already said, be contrary to the principles of accounting for the purpose in view.

155. Some of the replies refer to the 'individual method' or 'pick and choose' method of stock valuation as distinguished from the 'Global method' and express a preference to the 'Individual method'. Thest two methods were to a certain extent examined by the Madras High Court in 1948, II M.L.J. 525—Referred Case No 33 of 1947, *Commissioner of I.T. and E.P.T.*

Madras vs. *Messrs. Chari & Ram, Madras.* On the facts of the case as stated by the High Court the method followed by the assessee, a dyestuffs and chemicals dealer, of valuing his opening stock and closing stock "was to take the average cost or market value, whichever was lower, in respect of each separate article of the stock". In the year under consideration, the average cost of the opening stock was in respect of all the items lower than the market rate and so the assessee valued the opening stock on the average cost basis. "At the time of valuing the closing stock with regard to some of the articles the market rate was lower, whereas with regard to the other articles the market rate was higher than the average cost. Therefore, the assessee took the average cost as the value of the closing stock for those articles of which the cost was lower than the market rate and adopted the market rate for other articles of which the market rate was found to be lower than the average cost". The Commissioner urged the correct method to be "to arrive at two separate valuations of the closing stock one the aggregate cost price of each of the articles and the other the aggregate of the market value of the same articles and to adopt the lower of the two averages". The Court held that the method followed by the assessee was correct, not, however, on the ground that the assessee's method of valuation of stock was better than that preferred by the Commissioner but on the finding of fact that the assessee had been regularly following the same method as he applied in valuing the closing stock in the year under discussion. There is, however, the following passage in the last but second paragraph of their judgment, which shows the recognition by the learned Judges of the 'Individual method':—

> "......There is no provision of law or principle according to which the assessee could be compelled to adopt either the average cost for all the items or the market rate for all the items".

The method thus permitted is the 'Individual method' as against the 'Global method' suggested by the Commissioner of Income-tax. We see no strong reason to hold that this decision of the Madras High Court will create a hardship or that it might work to the detriment of the revenue. We are informed that the Departmental view in England also is opposed to the 'Individual method'. In other words, the Department would insist that if an assessee prefers the cost or market price basis, whichever is lower, he should apply either the cost or market price basis to the whole stock and not one method to some items of the stock and another to the other items. In *Brigg Neumann & Co.* vs. *Commissioners of Inland Revenue* (12 Tax Cases 1202), Mr. Justice Rowlatt supported the contention that parts of the stock may be valued differently. Section 31 of the Australian Act distinctly supports the 'Individual method': "The value of each article of trading stock (not being livestock) to be taken into account at the end of the year of income shall be at the option of the taxpayer its cost price or market selling value or the price at which it can be replaced". Regulation 111 of the Revenue Code of U.S.A. prescribes "Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article". Thus, the U.S.A. practice also favours the individual method.

156. Perhaps, the most important objection to the 'Individual method' is the amount of labour that will be involved in checking the valuation, but any valuation to be checked calls for a comparison of values of cost or market in respect of each item, whatever the system of valuation that is employed, in a mercantile concern where the stock comprises various articles. The individual system will call for no greater exertion. Therefore, on the ground of labour, there is no advantage in the Global method over the Individual method.

157. The other objection to the Individual method of valuation is on the ground that it will vitiate the taxable income by introducing a further concession by way of precautionary reserve against later losses. This argument carries the implication that any departure from cost price is by itself a concession to such Reserve. As it is not proposed, however, to withdraw that concession, it cannot be denied that an assessee would be entitled to value his stocks on any one of the three approved methods. The stocks are not one inseparable lot, but consist of several items. Each of them was purchased individually and would be sold individually. Each item has its own market value as well as its own distinctive cost value. Therefore, each item of stock is capable of being valued separately and we see no sound reason why this should be prevented.

158. It has been suggested that rules should be prescribed as under the U.S.A. Revenue Code for valuation of stocks. Our attention has been drawn in one of the replies to our Questionnaire to the following summary of the instructions in that code:—

"(i) Fundamental requirements—

(a) they must conform to the best accounting practice in trade or business;

(b) they must clearly reflect income.

(ii) Two inventory valuation bases either of which may be adopted.—

(a) cost and (b) cost or market value, whichever is lower.

(Other methods are generally not recognised).

(iii) In (b), the principle must be applied to each item of inventory. Accordingly, a taxpayer is not permitted to inventory the entire stock at cost and also at market value and use the lower of the two results.

(iv) Dealers in securities are allowed a third optional method—market only.

(v) Inventoried goods which are unsaleable or unusable in normal transactions because of wear and tear, obsolescence or broken lots, should be valued at *bona fide* selling price less cost of selling, *i.e.*, at the actual offering of goods during a period ending not later than 30 days after inventory date. Adjustment of the valuation on a reasonable basis, not less than scrap value, is permitted in case of unsaleable raw materials or partly finished goods.

(vi) Inventories at cost: The cost of goods produced by the taxpayer after the beginning of the year includes (a) cost of raw materials and supplies entering into or consumed in production of the product, (b) the direct labour expenditures, and (c) indirect expenses incurred in producing goods, including cost of selling or return of capital.

(vii) The cost of goods purchased during the year means the invoice price less discount. Cash discounts may be deducted from the invoice at the option of the taxpayer, if a constent course is followed.

(viii) Where ordinary rules for computing cost cannot be availed of, cost may be approximated on reasonable basis in conformity with established trade practice.

(ix) The system of inventory known as the "base stock" method, which consists of valuing at a constant price, all the material which did not exceed in quantity the normal stock on hand is disapproved.

(x) **Last-in-First-out Rule.** The Last-in-first-out rule of inventorying merchandise is available to any taxpayer who uses the method consistently, provided their election of the method is approved by the Commissioner."

159. An elaborate system built up by rules is made necessary in the U.S.A. Code by the direction contained in section 22 (c) of that Code to the Commissioner to prescribe the basis of valuation. There is no such direction under the Indian Act and we have held that there is no need to introduce it. To our mind, the instructions as prescribed in the U.S.A. import nothing new and cannot claim to be comprehensive. All the instructions prescribe the rules followed generally in commercial accounting. But commercial practice also gives latitude to individual traders to make adjustments suited to particular conditions and circumstances. The elastcity, which has its obvious advantages in a country which is still building up its trades and manufactures will be lost within the rigid boundaries of prescribed rules. Moreover, the requirements of all trades are not similar and to bring all possible permissible variations within the compass of a set of rules is not only difficult but might also open the way for disputes. We see, therefore, no need, at least at the present stage, to enforce an elaborate system of rigid rules for stock valuation in this country. The Indian Act is already strong enough to insist on correct valuations being supplied. The rules can only reduce this trength, which we think is inadvisable in this country, where modern accountancy training is comparatively new and old indigenous accounting methods are strongly entrenched behind tradition and custom. The powers of the Income-tax Officer under section 13 are capable, with proper care, of being used to keep watch on the trend of accounting methods, and, for this purpose, it will be sufficient, we think, if Income-tax Officers are instructed administratively to observe principles somewhat on the lines incorporated in the U.S A. Regulations with variations suited to local practice. This will secure uniformity of practice and help in the gradual training of the trade where necessary.

L.—Usufructuary Mortgages

(Question 23).

160. The law relating to the taxability of income derived by a usufructuary mortgagee of agricultural land is far from satisfactory. The decision of the Privy Council in the Darbhanga case (1935 I.T.R. 305) was based on the specific exclusion of "agricultural income" from the Act, independently of the 'character of the recipient'. But, as pointed out by the Ayers Committee, it could hardly have been the intention of the framers of the Income-tax Act that interest income derived from lending money to land-owners should be exempted. Apart from the difficulties created by the distribution of subjects between the Centre and the Provincial Legislatures, the justification for the exemption of agricultural income from income-tax was that the land paid land revenue but when a mortgagee of land enters into possession, he reckons upon realising a fair rate of interest on his loan *in addition* to the land revenue burden. So much of his income as represents the interest differs in no material respect from any other kind of interest realisation It would be anomalous to make the assessability depend upon whether the mortgagee himself is in possession or whether he leases it back to the mortgagor or leases it to other tenants. If any difference is to be made at all, there may be some reason to justify a distinction between cases where the mortgage deed contains no couvenant for payment of interest and those where there is such a covenant. In the latter case, the mortgagee can realise from the mortgagor whatever balance of interest remains after giving credit to the usufruct of the mortgaged land. From this it follows that the mortgagee's claim is essentially one for interest and that the transfer of possession is merely a mode of discharging it. We would, therefore, recommend the adoption of the advice given by the Ayers Committee

that the income derived by a usufructuary mortgagee of agricultural land be excluded from the definition of "agricultural income" in so far as it represents interest payable to him on the mortgage loan.

161. If the matter is properly appreciated, a provision of the above kind should not be held to involve any interference in the Provincial sphere. There is in any event no justification for the mortgagee being allowed to escape liability altogether with neither the Centre nor the Provinces taxing this portion of the income. To allay any fear on the part of the Provinces, the question may well form the subject of an express agreement between the Centre and the Provinces.

M.—Premium on Leases

(Question 24)

162. The practice of taking premia in connection with leases has in recent years come so extensively into vogue that it is high time to have definite legislative provisions made as to their assessability to income-tax. The existing law leaves the matter in considerable uncertainty. The reported decisions in India relate mainly to the grant of mining leases or of leases by zamindars and the language used in some of the decisions is largely coloured by the special nature of such transactions. In the textbooks and in decisions, a premium is variously described as advance rent, capitalised rent, or as payment made for the acquisition of the right under the lease. A difference is sometimes made according as the lease is for a short term or for a long term, the inclination in the latter case being to regard it more as in the nature of a price. The discussion of the question whether premium constitutes income or not has often been regarded as concluded by the accountancy point of view.

163. There can, however, be little doubt that the payment of premia materially affects the rate of rent and it is not unfair to assume that the premium and the rent together constitute the benefit which the lessor gets out of the transaction. The tendency in England has been in favour of regarding premium as in the nature of a capital receipt on the one side and an item of capital expenditure on the other side. The law in Australia has definitely departed from this view and the Australian Income-tax Act has made elaborate provisions in sections 23, etc., for the assessment of the benefits derived by a lessor from a lease transaction. Whether we require all those provisions here may be a matter on which difference of opinion is possible; but we think that premia received in connection with a lease should be treated as part of the lessor's income. It has sometimes been said that the question is not of much consequence from the revenue point of view, because if the premium should be treated as a revenue receipt in the hands of the lessor, it should be allowed as a revenue deduction in favour of the lessee. But it is not every lessee who can claim a deduction in respect of rent paid by him or of premia paid by him. It will be material only in respect of premises used for business purposes. Even were it otherwise, the matter should be dealt with as one of principle and not of mere revenue expediency.

164. If the premium amount is to be regarded as an item of taxable receipt, the question arises as to the proper way of bringing it to assessment. There are strong reasons against including the whole amount in the assessment for the year in which payment was received, especially if the lease is for a term of years. Where the lease is not for a specified term, it may not be wrong to take the whole amount of premium into account in the year of receipt. Where the lease is for a stated period, the fairer method will be to distribute it over the period of the lease (see *Abbot* vs. *Davies*, 11 T. C. 575), though this may not be the mathematically correct method. If the lease is terminated before the expiry of the term fixed, the balance of the premium would become chargeable in the year of termination of the lease except where it has to be returned to the lessee. The same principles will have to be

followed in making a deduction in favour of the lessee in cases in which he may be entitled to a deduction. As the payment of premium is often kept secret, we are elsewhere in this report (paragraph 184) recommending that the Income-tax Officer should have power to ask for a sworn statement in the matter and that an obligation should also be imposed on the lease to report the fact of payment of premium to the Income-tax authorities in certain circumstances.

N.—Unclaimed Balances

(Question 25)

165. This question relates to a suggestion that unclaimed and waived surpluses to the credit of customers, suppliers and employees, to the extent they are made up of deductions or allowances previously allowed as admissible expenditure when determining assessable income may be deemed to be "profits" if they have remained unpaid for over three years. Some of the replies have overlooked the qualifying words "to the extent they are made up of deductions or allowances previously allowed as admissible expenditure". Anything in the nature of capital items like customers' deposits was not intended to be touched at all, nor is it the intention of the proposal that any employer or trader should be compelled to plead limitation when the person entitled to claim the balance comes forward to make the claim even after the expiry of the period of limitation. Once these implications are clearly understood, the general gist of the replies is in favour of the proposal and we recommend accordingly. A few of the replies have suggested that such items should be deemed as profits only if and when the employer or trader carries them into his profit and loss account. We see no justification or use for this restriction. It seems to be the widespread practice that such items are not carried back into the profit and loss account for long periods. In some of the other replies, a suggestion has been made that if the trader or employer does not carry them into the profit and loss account within a reasonable period, he should be compelled to do so to enable them to be treated as assessable income. There is little difference in substance between this suggestion and the proposal referred to in the question. It is more a matter of accountancy as to which will be the more convenient course. As we have indicated that there is no intention to compel the trader or employer to plead limitation, we do not attach much imporance to the point made in some of the replies that three years may not always be the rule of limitation applicable to particular claims. The three years limit was adopted only as a convenient working rule. It would also be a logical corollary of this rule that if and when the person entitled to these suspense items claims and is paid them, they will once again be allowed as admissible deductions in the year of payment. Some of the replies state that this is in fact being done by the authorities even now; but it will be better to put it on a legal footing as a course authorized by the statute or statutory rules.

166. A point has been raised that under labour legislation, the unclaimed wages fund is not the property of the employer and it has accordingly been doubted whether that fund can be treated as part of the profits of the employer for purposes of taxation. We have not been able to find any statutory provision to the above effect in the existing law; we only gather that there is a proposal to set apart unpaid wages as a separate fund for the benefit of labour. If such an enactment is actually passed, this recommendation cannot of course apply to such unclaimed funds based apparently on the ambit of that legislation. Another point has been raised based apparently on the decision of the Bombay High Court in *Tejaji Farasrom Kharamwalla* v. *Commissioner of Income-tax, Bombay* (1948 I.T.R. 260) that once a certain sum of money has been set apart as expenses of wages payable to labour, it would cease to be taxable

even if it has not been actually disbursed. Assuming that this would be the position under the existing law, that cannot stand in the way of legislation to a different effect.

O.—Superannuation Fund

(Question 26)

167. As objection has been taken in some quarters to the frame of our question on this point, as ignoring the distinction between a Provident Fund and a Superannuation Fund, we think it will be useful to state the true nature and working of a Superannuation Fund as we conceive it. In broad outline, the working of a Superannuation Fund is as under:—

(a) Deductions are made from the salaries or wages of the employees and are paid over by the employer to the fund;

(b) The employer contributes a further sum to the fund;

(c) These contributions from employer and employee are invested and the capital of the fund consists of the accumulated contributions with interest additions,

(d) On retirement, at a specified age or on previous incapacity, the employee receives from the fund a pension, based on the salary or wage received by him during his period of service with the employer;

(e) In the event of an employee dying before he becomes entitled to superannuation, his widow, children or dependents receive an annuity according to the rules of the fund.

Ordinarily the trade or undertaking in connection with which the fund is established should be carried on in India for being eligible for recognition by the Central Board of Revenue; but the Board can make an exception to this rule as also with regard to the return of contributions in certain contingencies. For recognition, the Trustees of the Fund should apply in writing to the Income-tax Officer before the end of the assessment year for which the recognition is sought.

168. The Royal Commission on Income-tax (in England) 1920 considered the problem of Superannuation Funds and made certain recommendations. In the event of an employee's contributions being returned to him, the Commission recommended that the employee should pay income-tax on such contributions "at a compounded rate or at an average of the rates at which he was liable while his contributions were being made. The income arising from the investments of the funds should also be exempt from tax, but if interest is paid to an employee in addition to his returned contributions on the happening of a contingency other than death, that interest should then be liable to income-tax in the same way as his returned contributions". According to the Commission, the interest included in the amount payable at death of the contributor should not be taxed because such interest would be indistinguishable from the other interest of the Fund paid in lump or periodically to the survivors. These and other recommendations of the Commission were incorporated in the U.K. Finance Act, 1921, which is the model on which the relevant provisions of the Indian Income-tax Act have been framed. Certain clauses of the former Act have been copied verbatim in the Indian Act. Thus, clauses (a), (b) and (c) of Section 58P of the Indian Act are almost a reproduction of clauses (a), (b) and (c) of section 32 (3) of the U.K. Act; the terms of the provisos under the respective sections are also almost identical.

169. Although the Royal Commission's report was made in 1920 and Chapter IX-A which deals with Provident Fund was introduced in the Indian Act in 1929, the provisions regarding the Superannuation Fund in Chapter IX-B were not incorporated in that Act till 1939. The objective both of the Provident Fund and the Superannuation Fund being the same *viz.*, to provide for retirement benefits to employees, provisions under Chapter IX-A and Chapter IX-B are in many respects similar, but there are some points *e.g.*, the treatment of contributions, in which they differ. Thus the contributions by an employee to a Provident Fund determine the extent to which the employer may contribute to the Provident Fund except for periodical bonuses and other contributions of a contingent nature. This restriction is waived only in the case of an employee whose salary does not exceed Rs. 500 a year. In the case of a Superannuation Fund however, there is no such restriction, the only provision on the point being that in 58P (c) which says "the employer in the trade or undertaking shall be a contributor to the Fund". Contributions by an employee to the Provident Fund are to be a definite proportion of his salary for that year [58 (c) (1)]. In the case of the Superannuation Fund "ordinary annual contribution" is less definite, and although a fixed amount, it is to be computed with reference to earnings (and not salary as in the case of the P. F.), the contributions or the number of members of the Fund. Under section 58-E of the Indian Act, "the annual accretion in any year to the balance at the credit of an employee participating in a recognised Provident Fund, shall be deemed to have been received by him in that year, and shall be included in his total 'income for that year' and shall, subject to certain restric about amounts, be liable to income-tax and super-tax" There is no provision affecting the treatment of contributions to the Superannuation Funds. There is a maximum rate prescribed for interest included in the accumulated balance of an employee up to which exemption is adimissible, but no such rate is prescribed for Superannuation Funds.

170. Even in the manner of granting recognition, there is a distinction between a Provident Fund and a Superannuation Fund. In the case of the former, the Fund has to satisfy the Commissioner that it fulfils not only the conditions prescribed by section 58-C but also those in the rules mentioned in section 58-L. These rules prescribe the limits for contributions, the type of investments to be made, as also conditions intended to secure further control over the recognition and administration of Provident Funds. On the other hand, the Central Board of Revenue, in according recognition to a Superannuation Fund, has merely to satisfy itself that the requirements under section 58-P are fulfilled. It has been argued under section 58-O, the option lies with the Central Board of Revenue to accord recognition to a Superannuation Fund or to refuse it and that in exercising such option the Central Board of Revenue might insist on certain conditions being observed. This construction is based upon the word "may" which precedes the word "accord" in section 58-P are fulfilled. It has been argued that under section 58-O, the option is made to depend on the Central Board of Revenue's opinion as to whether the Fund complies with the requirements of section 58-P. Therefore, if all the requirements of that section are satisfied, it is doubtful if the Central Board of Revenue can refuse to recognise the Fund. Nor can the power to impose conditions regarding the extent of contributions, etc., be imported through this option. If the legislature intended that the Central Board of Revenue should have the power of imposing conditions, it would probably have said so, as it has done in the case of the provisions in respect of the Provident Fund. There is no doubt a reference to conditions in proviso to section 58-P, but even those conditions can arise, we think, in respect only of the three eventualities mentioned in the proviso and not in other circumstances independent of these contingencies.

171. The great majority of the replies received by us to our Questionnaire agree to the suggestion that the provisions of the income-tax law in respect of Superannuation Fund should as far as possible be brought into line with those relating to Provident Fund. Almost the only objection to the proposal comes from the Bengal Chamber of Commerce who think that the difference in the method and manner of provision of benefits under the two Funds would justify the existing distinctions. We do not think this is wholly so. It is, for instance, difficult to see why the power given to the Central Government to make rules as in section 58-L (2) should not be repeated in the case of the **Superannuation Funds. This omission is all the more inexplicable in view** of sub-section (4) of section 32 of U.K. Finance Act, 1921, on which Act the Indian provisions are modelled. Under the English Act, Commissioners have been given power to "make regulations generally for the purpose of carrying this section into effect and in particular without prejudice to the generality of the foregoing provisions may by such regulations.........(e) provide for determining what contributions to a Superannuation Fund are to be treated as ordinary annual contributions". In the absence of such rule-making power, the Central Board of Revenue will have to accept any contribution as "ordinary annual contribution" which satisfies the condition that it is a fixed amount or is computed on a definite basis, Secondly, as the annual contribution is related not to salary but to earnings, it may be even as much as, if not even in excess of, salary. Also, as no limits have been fixed in the Act for contributions by an employer and no rules can be prescribed under the existing law restricting such contributions, the employer's contributions need not bear any relation to the employee's salary. Fourthly, though the Fund will be working in India, there is no provision in the present Act to prevent its investments being made outside the country. We think this lack of power to make rules is a serious drawback in the scheme of Superannuation Funds under the Income-tax Act, of which unfair use can be made. Thus, if a firm converts itself into a company and employs the quondom partners as managers, thus making them employees, under the scheme of Chapter IX-B of the Income-tax Act the Company can very well transfer regularly a large part of its profits to a Superannuation Fund, of which the managers would be beneficiaries and such contributions would be exempt from tax. Further, the managers have only to claim commutation of their annuities and through such commutation receive all or the major part of all contributions; such commuted amounts would also be exempt from tax (*vide Commissioner of Income-tax*, Bengal *v.* Fletcher--1937 I. T. R. 428). Doubt has been expressed in certain quarters as to the feasibility of such evasion on the ground that under the scheme of Superannuation Fund, 'commutation' is not expressly mentioned. This doubt is repelled by the proviso to Explanation 2 in Section 7 (1) of the Income-tax Act, where occur the words "in lieu of or in commutation of an annuity". This proviso specifically exempts such payment from income-tax. In Chapter IX-B itself, there is a reference to commutation in section 58-V and we think commutation is **not debarred by the words "provison of annuities" as used in section 58-P** (b) which would include any method of payment, whether periodical or in lump.

172. That evasion can be practised in other ways also is evident from the following extract from "TAXATION" of the 27th December 1947:—

"It has long been common knowledge that the device of utilising benefits arising on retirement as a means of legitimate tax avoidance

has been becoming increasingly popular. In the main there were two ways of reducing tax liability. They were as follows:—

1. Company A. engages a senior official somewhat late in life and pays him a comparatively low salary but at the same time gives him an agreement under which he will, after only a few years' service, receive a pension of substantial proportions. By spreading his remuneration over a longer period in this way the higher rates of sur-tax were avoided.

2. Company B. effects, on the life of say its managing director, an endowment assurance policy for a substantial sum and pays the premiums. Under the terms of the contract the managing director, or his estate, is entitled to the sum assured only if he is still in the service of the company when the benefit becomes payable. The company could treat the premium as an expense for tax purposes but because there was a contingency on which the sum assured did not accrue to the managing director or his estate, the premium could not be treated as part of his taxable income. Neverthless if, and when, he did receive the benefit it was not taxable in his hands."

In America also, it would appear that it was the practice for some closely held and closely controlled corporations to distribute profits in the guise of pensions where the corporation would have distributed the profits direct to the officers concerned were it not for the tax advantages gained by resort to the pension trust plan. To avoid such practices, one of the suggestions made was to impose a restriction as to the amount of pension, which can be thus declared exempt. But, whatever the remedy may be, it seems to be appreciated that a pension trust should not be permitted to be converted into a device for paying additional salaries or dividends.

173. If loopholes in the English Act could be used for tax evasion in England, in spite of the powers given to the Commissioners under sub-section (4) of section 32 of the U.K. Finance Act of 1921, the danger of such evasion is greater in India, where even such rule-making powers do not exist. We think that the provisions of the Indian Act with respect to Superannuation Funds need to be amplified and a general power must be given to the Central Board of Revenue to make rules or regulations as has been given to the Commissioners in U. K under section 32 of the Finance Act of 1921. We further suggest that provision should be made in the Act itself similar to the following regulation 8 of S. A. Fund under the U.K. Act (as amended in 1931), as an exception to proviso to explanation 2 of sub-section (1) of section 7 of the Indian Income-tax Act:—

"Where any contributions (including interest on contributions if any) are repaid to an employed person during his life time or where a lump sum is paid in commutation of or in lieu of an annuity, income-tax on the amount so repaid or paid shall, except in the case of an employed person whose employment was carried on abroad, and in the case of a person who is the widow, child or dependent of an employed person, whose employment was carried on abroad, be paid by the trustees of the fund who shall make such payment at the rate of one-fourth the standard rate in force for the year in which the repayment or payment is made and the said tax shall be a debt due from the trustees of the fund to the Crown and recoverable accordingly."

The rate of tax in the above quotation would, of course, have to be suitably adjusted to Indian conditions.

174. We have suggested that the amendment should be effected by a provision in the Act itself for two reasons:—

(i) As a rule cannot override the provision in the Act, the provision cannot be introduced by a rule as any such rule being repugnant to proviso to section 7 (1) will be *ultra vires*.

(ii) Even if the proviso to section 7 (1) were amended by deletion of the reference to commutation, etc., it is possible in view of the Privy Council decisions (in *Commissioner of Income-tax, Bengal vs. Shaw Wallace & Co.*—6 I. T. C. 178—and *Commissioner of Income-tax, Madras v. Fletcher*—1937 I.T.R. 428) that in the absence of an express provision to the contrary, commuted amounts will be held as capital receipts in the hands of the recipient and therefore exempt. We do not think that in taxing the commutation amount any violence will be done to the principles of taxation. Firstly, the receipt is in effect a return of the amounts exempted in the past to the assessee under section 15, and, secondly, the payment is in essence an advance payment in lump of future annual taxable income At what rate this tax should be paid would, no doubt, depend on the circumstances of each case.

175. Of the three suggestions on which views were called for under the heading 'Superannuation Fund' in the Questionnaire, the first merely proposes to restrict the maximum limit to which contributions by employee and employer may be made. Under section 15, an employee gets an exemption from tax up to one-sixth of his total income which is 16-2/3 per cent. The proposed limit of 25 per cent being 1½ times the exempted limit should leave a sufficient margin for individual zeal for thrift, and will also restrict the chances of abuse, referred to above. Under the U. K. Regulations, the employer's contributions (including any voluntary additional contributions) are not to exceed 15 per cent of salary in the case of an individual. We recommend that suitable amendments be made in the Indian Act, incorporating the changes above proposed in Chapter IX-B.

176. The first part of the second suggestion is virtually included in section 58-B according to which the contribution is "treated for all purposes of the Act as if it were a sum to which the provisions of section 15 apply". If there be any doubt on this point, it may be removed by suitable amendment to make the meaning clearer The second part of the suggestion seeks to bring the treatment of accretions to the Superannuation Fund into line with those to the Provident Fund. If given effect to, we think the proposal will introduce a serious difficulty in its administration. If a contributor lives to enjoy an annuity under the terms of the contract, all interest earned on the contributions will be a part of the annuity payments which he will be receiving from the Fund, and as the taxed portion will not be distinguishable in such payments from the untaxed one, it is likely to suffer double taxation. On the other hand. the chances of high rates of interest being realised on Trustee securities are slight; and as it is also proposed that restrictions be placed on the type of investments to be allowed to Superannuation Funds, the possibilities of other investments being resorted to are rare. No misuse is, therefore, likely to occur in the present circumstances We do not, therefore, make any recommendation in respect of the second part of the second suggestion contained in the question.

177. The main opposition is to the third suggestion. Two arguments that lend strength to this opposition are:— that the employee may or may not actually receive either any benefit or the full benefit accruing from the contributions to the Fund. and that as the contribution is made by the employer to the Fund as a whole, no part of such contribution can be earmarked as the income of a contributing employee in any year and from year to year. In the case of Provident Fund contributions, on the contrary, the employer

contributes specifically to the account of the employee proportionately to the employee's contribution and the whole of such accretions eventually is received by the employee or, on his death, by his survivors. We think there is considerable force in these arguments and we agree that provision similar to that in section 58-E would be difficult to work in connection with a Superannuation Fund. Recently, the U.K. authorities appear to have reviewed the position with regard to taxation of provision of retirement benefits to employees. As a result of such review, certain amendments were introduced by the Finance Act of 1947, particularly sections 19 (1) and 20 (3) of that Act. The words of section 19 (1) might lend themselves to the construction that any sums paid by a body corporate with a view to the provision of the retirement benefits for a director or employee are taxable as his income during the year of such payment, in respect of which, under section 20 (3), the director or employee will be able to claim relief if the benefit ultimately does not accrue to him or is not likely to accrue to him. But a statutory superannuation scheme is specifically excluded from the operation of section 19 (1) as also payments made to a Superannuation Fund approved by the Commissioners. We agree, therefore, that it would be inequitable to extend the provisions of section 58-E to Superannuation Funds. In taking this view, we are referring only to the kind of Superannuation Fund which, appears to us, is contemplated in the scheme in Chapter IX-B of the Act. That scheme does not include the other methods of providing superannuation benefits such as are provided through Life assurance. This kind of provision is made principally by small employers and other employers, who wish to save themselves the trouble of managing a trust fund. The employers thereunder make premium payments to Insurance Companies to secure an endowment insurance policy or recurring annuities to their employees according to last salary or average salary earned by these employees. The insurance is in some instances made for a group of employees as a whole or for individual employees. If such schemes are at all to be considered, we would suggest that the benefits being capable of being traced to individual employees, the contributions might be included in their incomes on the lines of section 58-E and that relief should be granted in respect of such contributions under section 15 to the extent the employee would be entitled to, if the contributions were life assurance premium payments made by the employee direct.

178. In a communication addressed to us, Messrs. Burmah Shell Oil Storage and Distributing Co. of India, Ltd., suggest that amendments may be made to sections 58-C and 58-G of the Income-tax Act so as to make it possible for employees who had retired from their service and of companies which maintain a Provident Fund to retain the benefit of the Fund after retirement. The proposal in effect is as follows:—

"It should be optional for trustees of Provident Funds recognised under the Indian Income-tax Act:—

(i) to retain as deposits in the Fund subject to withdrawal on demand in whole or in part sums due to members who have retired from employment,

(ii) to credit or pay the depositors interests at the average rate of interest earned during the year by the Fund,

(iii) to deduct income-tax at the highest rates on sums paid or credited under (ii) above and to give a certificate to the depositor showing the interest credited or paid to him and the income-tax deducted therefrom, and

(iv) to pay to Government the income-tax deducted under (iii)".

This is proposed to be achieved by adding to clause (d) of section 58-C (i) a proviso as under:—

"Provided, however, the Fund may also consist of the accumulated balances due to any member of the Fund who has ceased to be employed and of interest, simple or compound, in respect of such balances where such balances are retained in the Fund in accordance with clause (g) hereof"

and by adding to clause (g) of section 58-C (i) the following words:—

"Except where, at the request of the employee, the whole or any part of the balance due to him is retained in the Fund to be drawn by him on demand".

The object of the request has been stated to be two-fold: Firstly, that the subscriber's balance may earn a reasonable rate of interest from investment in gilt-edged securities without any effort on the part of the member and, secondly, to avoid the risk of loss of capital. It was pointed out by us to the company in reply to their letter that, as these retired officers would not be getting any salary from the company and would have no employer as such, the amount of one-sixth of the salary mentioned in section 58-F would be nil and, therefore, the total interest receivable on the balances retained with the Fund would be taxable in the members' hands. Thus, the request they made would give no exemption from tax on the interest earned. The company accepted this position On this undertaking we are in sympathy with the company's proposal and, as the object seems to be honestly and straightforwardly to give certain facilities for protecting the hard-earned savings of a certain class of employees from being frittered away or lost in indiscreet investments, we think that suitable amendments may be made on the lines suggested above and also in the definition of the word "employee" in Chapter IX-A of the Income-tax Act.

P.—SUPER-TAX ON ASSOCIATIONS

(Question 27)

179. The point raised by this question is perhaps not of much consequence from the revenue point of view as the occasions for any escape of revenue on account of the defect referred to in the question cannot be many. What is now the second proviso to section 55 of the Income-tax Act has come down from the previous law where it was the only proviso to section 55 of the Income-tax Act of 1922. The problem to which the question relates arises in the following manner: Unlike a registered firm, an unregistered firm or association of persons may be subjected to a single assessment as a body and not individually on its members. This single assessment may be both in respect of income-tax and of super-tax. The individual members of such associations will also be subjected to super-tax under the main provision of section 55 in respect of such portion of the Association's income as they may receive, provided that their total income is above the super-tax minimum. Conceivably this may result in a double levy of super-tax on the same income. To avoid this, the proviso in question enacted that where the profits and gains of an unregistered firm or other association of persons not being a company have been assessed to super-tax, super-tax shall not be payable by a partner of the firm or a member of the association, as the case may be, in respect of the amount of such profits and gains as is proportionate to his share. In the practical operation of this proviso, a situation like the following may arise: An association may have an income of Rs. 30,000 out of which super-tax will be paid on Rs. 5,000. A., one of its five members, may have his own individual income of Rs. 30,000. His share out of the Association's income will be Rs. 6,000, making a total income for him of Rs. 36,000. Under the

main provision of section 55, he will be liable to pay super-tax on Rs. 36,000 minus Rs. 25,000, *i.e.*, Rs. 11,000. But, as the result of the proviso, his whole share of the Association's income, *viz.*, Rs. 6,000, is excluded from super-tax and he will pay super-tax only on Rs. 5,000, though his share of the Association income ***which sufferd super-tax*** was only Rs. 1,000 *i.e.*, one-fifth of Rs. 5,000. It is to this lacuna that the question refers. We are not satisfied that this was intentional. The principle that the same income should not be subjected to super-tax twice is right; but, on the facts above stated, only Rs. 1,000 of the share pertaining to A has suffered super-tax as part of the Association's income, whereas his whole share is excluded from super-tax by the proviso. This result may be avoided if the second proviso to section 55 is recast so as to make A liable to super-tax in the ordinary course but giving him credit on the analogy of section 49-B for the super-tax paid by the Association in respect of his share of the Association's income.

180. Some of the replies have pointed out that the above situation would not arise if the categories of unregistered firms and associations were altogether abolished and all assessments made on the individual members thereof; but, for the reasons which we have already explained in paragraphs 96 to 99, this is not practicable.

Q.—Avoidance and Evasion

(Questions 33 to 37)

181. Of the five questions grouped under this head, question No. 33 has already been dealt with (see paragraph 47 *supra*). Question 34 has become necessary mainly by reason of the fact that sub-section (3) of section 16 is in terms limited to income formally accruing to the *wife or minor child* of an assessee. The provision is capable of being defeated by transfers in favour of other near relatives; and instances have indeed come to our notice of attempted transfers in favour of grand-children and illegitimate children. Though the question also refers to section 16 (1)(c), no instances of attempts to get round that provision have been brought to our notice and we do not, therefore, say anything about it. Many of the replies remind us that it is a common practice in this country to make presents to young relatives on various auspicious occasions and that there is no justification for condemning or attempting to check such practices or throwing doubts on the validity of genuine transfers in favour of such near relatives. This criticism proceeds on a misapprehension of the purpose of the question. Like section 16 (3) itself, the question assumes that as between the transferor and the transferee, the transfer is operative and is not a nominal or fictitious transaction. The justification of the provision in section 16(3), even as it stands, is that a person who attempts to provide by way of capital transfer for the maintenance or convenience and comforts of a person whom he is otherwise likely to have maintained or provided for out of his own income should not, by reason of such an arrangement, escape liability to income-tax in respect of income which, but for such capital transfer, would have been received by him and then disbursed for the maintenance or advantage of the relative or dependant. This reasoning applies not merely to transfers in favour of one's wife or minor child but equally to transfers in favour of persons standing in a similar position, particularly one's grand-children and illegitimate children. The corresponding provision of the English law includes step-child and illegitimate child within the meaning of the term "child". In view of English ways of life, it was probably considered unnecessary to include grand-children in the category. Under Indian conditions, it will be safer to include grand-children as well. It cannot be said to be beyond doubt whether child will include an adopted son in this context. It will, therefore, be better to include an adopted son also specifically. The same reasoning will apply to foster-child, especially in Mahomedan families. We therefore recommend that an explanation

may be added to section 16, sub-section (3), to the effect that for the purpose of that sub-section, the word "child" shall include adopted child, foster-child, step-child, illegitimate child and grand-child.

182. The case of nephews who are also referred to in the question stands on a slightly different footing because the rationale of the provision in section 16 (3) may not strictly apply to them. We have, however, come across instances in which dispositions of the kind referred to in *Commissioners of Inland Revenue v. Clarkeson-Webb.* (Law Reports 1933—I. K.B. 507) had been made in this country, *i.e.*, each of two brothers making similar settlements in favour of the minor child of the other brother. In the English case, Finlay J. was prepared to ignore the form of the transaction and hold that the case fell under section 20, sub-section (1) (c) of the English Finance Act, 1922, which, in substance, resembles section 16 (3) of the Indian Income-tax Act. The learned Judge admitted that the case was not free from difficulty and it is not easy to say what view would be taken if a similar case should come up before the courts in India. We notice that this point was raised during the debates before the legislature in connection with section 16, sub-section (3), but no provision was made for it. So far, arrangements of this kind have not come up before the courts in this country and it may be presumed that they are not frequent. It is for the Government to consider whether any specific provision should be made in respect of this class of cases.

183. The second point referred to in question 34 has become important in view of two decisions of the Bombay High Court (*Cambatta's case* 1946—I.T.R. 748—and in *re Shri Shakti Mills Ltd.*—1948 I.T.R, 187). These decisions have laid stress on the fact that under the Companies Act, the person entitled to a dividend is only the registered shareholder and not a mere beneficial owner. Where shares stood in the name of husband and wife, it was held (in one of the cases) to follow from the above principle that they should be assessed as an "association" in respect of dividends thereon deemed to be distributed under section 23-A of the Income-tax Act. Though the decisions themselves did not relate to any question under section 16(3)—and in fact the judgment in the first case specifically saved the operation of section 16(3)—the reasoning is calculated to limit the operation of the principle underlying section 16, sub-section (3) considerably. We doubt if section 16(3)(a)(iii) and (iv) or even section 16(3)(b) can in terms be held applicable to a case where a person pays consideration to the owner of certain shares and gets them transferred in the joint names of himself and his wife, or himself and his minor child, or of his wife and his minor child. It therefore seems to us desirable to make express provision in respect of shares standing jointly in the name of a person and his wife or a person and his minor child. The appropriate provision will be that where the wife or child became entitled to an interest in the shares without any contribution, direct or indirect, by or from the estate of the other joint holder (being the husband or ancestor), each of the joint-holders must be assessed separately in respect of the dividend in proportion to their beneficial interest in the shares. In other cases, their share of the dividend should also be treated as part of the income of the husband or ancestor, as the case may be. We may have some more observations to make on the taxation of income from dividents when dealing with question 36.

184. Question 35 was posed on the assumption that if the transfer is to be ignored for the assessment of the income, it would be logical to ignore it even for the purposes of the recovery of the tax so assessed. There is, however, a danger that this may indirectly affect the title or interests of the transferee and may, in the event of subsequent disputes between the transferor and the transferee, place in the hands of the transferor the power to put the transferee to harm or trouble. We do not, therefore, think it right to recommend a provision on the lines suggested in the question. An alternative provision,

however, seems worth considering. The use of the word "shall" in section 16, sub section (3), would probably preclude the Income-tax authorities from treating the income referred to in the sub-section as the income of the wife or minor child. If by reason of events subsequent to the transfer, the husband or ancestor should lose his properties, there is no justifiable reason why the income accruing to the wife or minor child should not be independently assessed in the hands of the wife or minor child, as *ex hypothesi* the property or interest yielding the income is theirs. In this view, it may be legitimate to provide that if the tax in respect of the income of the wife or minor child cannot be recovered from the husband or the ancestor, as the case may be, the income may be independently taxed as that of the wife or minor child and the tax so fixed may be recovered from their property including the transferred property. The corresponding provision in the English law goes further and recognises the ultimate liability of the transferee by declaring the transferor's right to reimburse himself from the transferee's estate (section 20 (2) of the English Finance Act, 1922).

185. Question 36 was framed in the terms in which it runs because we felt that it was not within our province to deal with the question of the right or the wrong of the practice of blank transfers of shares and securities. We are only concerned with the repercussions of the practice on income-tax administration. Where neither the transferor nor the transferee will reveal the fact of the transfer and the Income-tax Officers does not become aware of the transfer, the assessment in respect of the dividend or interest must continue to be made on the registered holder. Where the fact of a transfer is disputed, the matter will have to be determined by the Income-tax Officer like any other question of fact. The only matter that the law can provide for is as to the course to be adopted by the Income-tax Officer when he finds that there has in fact been a transfer but that the shares have not been registered in the name of the real transferee. Independently of any question of registration, the obviously fair course, wherever the registered holder is not or has ceased to be the beneficial owner will be to treat the transferor or registered holder as a bare trustee and the real transferee as the beneficial owner and it will follow on general principles that the dividend or interest on the transferred shares or securities must be assessed as part of the income of the transferee or real owner except where the transfer itself is *ex-dividend* [see *Calico Printers' Association v. Commissioner of Income-tax, Madras*—(1948) 2 M.L.J. 536]. It is not clear whether the reasoning of the Bombay judgments referred to in paragraph 183 *supra* will preclude the adoption of this course. In any event, the stress there laid on the technical significance of the word "dividend" may give rise to administrative difficulties in giving effect to sections 16(2), 18(5), 20 and 49-B which specifically refer to "dividend". For instance, it will be an anomalous situation if the unregistered transferee of shares can be assessed as beneficial owner, but he cannot claim refund or credit under section 49-B because he did not draw the dividend as such. A question may also arise whether the shares even though not registered in the beneficial owner's name may be sold for realization of income-tax due from the beneficial owner. It seems desirable to make specific provision in respect of these matters. To this end, a clause may be inserted in the definition section to the following effect:—

> "'Shareholder' is the person beneficially entitled for the time being to the share or to the dividend payable in respect thereof."

186. In paragraph 183 *supra*, we have referred to the Bombay judgment wherein it was held that if shares stand in the name of two or more persons, they may have to be assessed as an association, so far at any rate as an assessment under section 23-A was concerned. The reasoning of the judgment may have a wider application as well. The anomalous consequences of this method of assessment were pointed out by the Ayers Committee in Chapter III, section

4 of their Report. They said "Consider the case of a man with a salary of Rs. 12,000, he and his wife receiving Rs. 1,600 from investments in their joint names. In this case the husband and wife being treated as an "association of individuals", a shareholder can claim refund of the whole tax appropriate to the dividend although the husband's rate of tax is one anna in the rupee" (as the law then stood). The anomalies will be even greater under the present law. The case of husband and wife has no doubt been provided for in section 16(3), but take any other case of two or more persons purchasing or holding shares jointly or even inheriting them. It certainly could not have been the intention of the law that there should be a separate assessment on them as an association, while there may be individual assessments in respect of their other income, and as section 23(5)(b) deals only with unregistered firms and not with associations (other than firms) the share of the dividend received by each member of this group cannot be aggregated with the individual income for purposes of income-tax (though this may be done for the purpose of super-tax unless the association has itself suffered super-tax). It is to avoid such anomalies that section 9(3) was, on the recommendation of the Ayers Committee, added in 1939. The sub-section runs as follows:—

> "Where the property is owned by two or more persons and their respective shares are definite and ascertainable, such persons shall not in respect of such property be assessed as an association of persons, but the share of each such person in the income from the property as computed in accordance with this section shall be included in his total income."

In the illustrations above given, the persons in whose joint names the shares may stand will hold them as co-owners and the principle of section 9(3) must be applicable to them. But, as has happened in a few other instances, this principle was not laid down in the Act as a general principle applicable to various kinds of income, but was added as part of section 9 which relates only to assessments of income from *property*. Income from dividends is assessed not as income from property but as income from "other sources". It seems, therefore, necessary to remove sub-section (3) of section 9 from its present place and enact it as an independent provision applicable to all kinds of income. To make the statement of the law complete, it may be necessary to add two more provisions on the following lines: Where shares in companies stand registered in the name of more than one person, they shall be deemed to be held by them as co-owners and the income derived by them by way of dividends on such shares shall, subject to the provisions of section 16, be assessed in the manner indicated in what is now section 9(3). As section 9(3) requires the respective shares to be definite and ascertainable, another clause to the following effect will be necessary: In the absence of evidence as to the respective beneficial interests of persons in whose name shares may jointly stand, they shall be presumed to be entitled to equal shares therein. To enable the Income-tax authorities to obtain information as to the beneficial ownership of shares not merely for the purposes discussed under question 36 but also for many of the purposes dealt with under the head "Private Companies", it seems necessary to insert in section 38 a provision similar to rule 11 of the First Schedule to the English Finance Act, 1922. The rule runs as follows:—

> "Any person in whose name any shares of a company are registered shall, if required by notice in writing. * * * * state whether or not he is the beneficial owner of those shares and if not the beneficial owner of those shares or any of them, shall furnish the name and address of the person or persons on whose behalf the shares are registered in his name."

The English rule goes on to enact a penalty for non-compliance, but that part of the rule need not be reproduced here as section 51(c) will attach the penalty once the provision is inserted in section 38. If, however, it is preferred that

instead of a prosecution under section 51, the Income-tax Officer should have himself the power to impose a penalty, provision may be made accordingly. The English rule provides that the defaulter shall be liable to a penalty of twice the amount of super-tax that would be chargeable at the highest rate in respect of the amount of the income apportioned to such shares.

187. The second part of question 36 is covered by the above remarks and it is not necessary to say anything more about it. But in the first part itself, there are two more possibilities referred to, namely, attempts at concealing profits made in share dealings and at claiming genuine or fictitious losses while concealing profits. These are questions of fact on which no general observations or suggestions can be usefully made. Some help in dealing with them may be provided by law if the suggestion that we have made in paragraph 134 *supra* is accepted, namely, that brokers may be subjected to an obligation to give information to the Income-tax authorities in certain circumstances.

188. Question No. 37 was framed in the light of a suggestion made apparently with reference to the wide terms of section 26(e) of the Australian Act which includes in an employee's assessable income all benefits allowed to him whether the benefits had come "in money, goods, land, meals, sustenance, the use of premises or otherwise". The Indian Legislature has not strictly followed the test laid down by the House of Lords in *Tennant v. Smith* (L.R. 1892 A.C. 150) that the advantage must be capable of being turned into money before it can be assessed as part of one's income In any view, so much of any allowance as falls within the terms of section 4(3)(vi) will of course be exempted. Section 7(1) includes "perquisites or profits" in the definition of "salaries". It cannot be said that some of the items specified in question 37 may not be comprised within the scope of the expression "perquisites or profits". In *Income-tax Commissioner v. Rev. J. C. Manry* (1942 I.T.R. 205), the Allahabad High Court held that allowances paid by a Mission to one of its employees for the education of his children would be comprised within the expression "perquisites or profits". Many of the replies to our Questionnaire stated that there is little evidence of any serious attempts at avoidance of taxation by resort to the ways mentioned in this question. They also expressed an apprehension that any attempt to cast the net of taxation wide with a view to include such cases may be hard upon poor employees who may be kindly treated by their employers. As the meaning of the expression "perquisites or profits" in section 7 has not so far been crystalised or unduly restricted by decisions, it seems to us that no special provision need be made for the present to meet cases of the kind referred to in this question.

R.—Bankruptcy and Winding up

(Questions 39 and 40)

189. Question 39 raises a point of substantive law and question 40 one mainly of procedure. When a person becomes bankrupt, the Bankruptcy Law (section 49 of the Presidency-towns Insolvency Act and section 61 of the provincial Insolvency Act) provides that *all* debts due to the Crown shall be paid in priority to all other debts except the claims specified in clauses (b) and (c) of section 49 of the Presidency-towns Insolvency Act and clause (b) of section 61 of the Provincial Insolvency Act, which alone shall rank *pari passu* with debts due to the Crown. It is not our intention to recommend any change in this part of the law, though it may be noted that under the English Bankruptcy Act, the priority is more limited. When a company goes into liquidation, the Indian law substantially follows the English law; and only a limited provision for priority is made in respect of revenue, taxes, etc., because priority is allowed only for so much as was *due* from the company on the dates specified in sub-section (5) of section 230 and has become due and payable within the 12 months next before those dates (see the con-

cluding words of section 230(1)(a) of the Indian Companies Act). The items of debts entitled to rank *pari passu* with Crown debts are larger in number under the Companies Act, but it was not our intention to raise any question in relation thereto. In the present state of arrears in Income-tax assessment, the words above quoted from section 230(1)(a), imposing a time limit, are likely to embarrass the administration seriously.

190. In *Governor-General v. Shiromani Sugar Mills Ltd.* (1946 I.T.R. 248), the Federal Court held that no general priority can be claimed in respect of tax due in winding up proceedings, on the basis of the prerogative right giving priority to Crown debts generally and that the priority admissible is only that allowed by section 230 of the Indian Companies Act. With reference to the time limit, the facts of that case may be noted to see how the claim of the Income-tax Department is likely to be affected in practice by section 230. The dates indicated in section 230, sub-section (5), are (a) in the case of a company ordered to be wound up compulsorily, which had not previously commenced to be wound up voluntarily, the date of the winding up order, and (b) in any other case, the date of the commencement of the winding up. In the Shiromani Sugar Mills case, the assessment related to profits alleged to have been made in the year ending 31st May 1940. The assessment year was therefore 1941-42, but the order of assessment was made only in February 1943. A petition to wind up the company had been presented on 26th November 1941, a provisional liquidator had been appointed on 7th December 1941 and a winding up order had been made by the High Court on 17th April 1942. The Court held on the above facts that the tax was not *due* from the company on the date of the winding up order and that therefore even the limited priority permitted by section 230(1) could not be claimed in respect of it. In *Durga Prasad v. Secretary of State* (1945 I.T.R. 285 at p. 289), the Privy Council observed that income-tax is due "when demand is made under section 29 and section 45; it then becomes a debt due to the Crown". In *Secretary of State v. Official Assignee* (1937 I.T.R. 677), the Judicial Commissioner's Court of Sind held that even income-tax not assessed on the date of the adjudication order would be entitled to priority under section 49(1) of the Presidency-towns Insolvency Act; in support of this view, the observations of Mellish L. J. Exp. Kemp L.R. 9. ch. App. 383 were relied on. We do not pause to consider the correctness of the Sind decision under the Insolvency Act; the language of the Companies Act will not permit of any such construction. Mellish L.J. emphasised that before a debt can be said to be *due*, a *sum certain* must have become due and though not *presently* payable, it must be *payable in all events*. According to the dictum of the Privy Council and the decision of the Federal Court above referred to, income-tax cannot be said to be *due* before assessment. As income-tax is payable out of the profits, it may be said that there is justification for the rule, long recognised in England, that priority should be given only in respect of one year's tax. But, under the corresponding provision of the English law (section 264 (4) (a) of the Companies Act). the difference in language would seem to allow preferential payment of one year's assessment if assessed for a period anterior to the winding up, *notwithstanding that the assessment is not made until after the winding up*. (See *Gowers vs. Walker*—Law Reports 1930 1 Chancery 262). It seems to us that the language of section 230, sub-section (1), of the Indian Companies Act should be amended at least to the extent of making the same view possible in India. Whether the period for which priority could be claimed can reasonably be extended to more than one year, is a matter on which there is room for difference of opinion. Such a situation can no doubt be avoided if the Income-tax authorities will be prompt in the assessment and realization of the tax, but we have got to take the Department with all its limitations and it will be too much to ask that special attention should be given to company cases merely on the contingency of a possible liquidation supervening.

191. It will be desirable also to make express provision for tax leviable in respect of profits (if any) earned after the commencement of the winding up or bankruptcy. In *in re Beni Felkai Mining Co. Ltd.* (1934 1 Chancery 406) it was held that payment of the tax in such circumstances can be directed by the Court to be made in its discretion as part of the "costs, charges and expenses of the liquidation" and that the question of priority also was within the Court's discretion. What exactly will be the position under the Indian law, whether income-tax due in the above circumstances can be regarded as failling within "costs and expenses of the winding up" within the meaning of sub-section (3) of section 230, is not clear.

192. Dealing next with the procedural point raised by question No. 40, it can scarcely be denied that it is important for the Income-tax authorities to become aware at the earliest possible opportunity of proceedings in bankruptcy or by way of liquidation because, apart from any question of priority, the State must be enabled to realise its dues in full at least when assets are available and as much of it as possible when the assets are deficient. Some of the replies have stated or assumed that the receiver or liquidator may be personally liable if he does not provide for the payment of taxes, etc., before the completion of the proceedings; but it may not always be worthwhile for the State to pursue the receiver or liquidator; and, apart from statute, the receiver or liquidator may be personally liable only if *with notice of the claim* in respect of the tax due to the State, he distributes the assets without making provision therefor (see *In the matter of the Watchmakers' Alliance and Ernest Godde's Stores Ltd.*—11 Tax Cases 117). Very probably the same condition will be necessary to enable the liquidator to recover the amount of tax from any contributory to whom the assets may have been wrongfully paid (see *In re: Aidall Ltd.*, 1933 1 Ch. 323). Some of the replies have suggested that it is the business of the Income-tax authorities to be on the look-out and complete the assessment as early as possible, so as to enable themselves to prefer a claim in good time either to the receiver or liquidator or to the court concerned. We do not think it right to impose this kind of alertness on Income-tax authorities, or, at any rate, to make the Government bear any loss arising from their failure to act with such alertness. It seems to us desirable to provide either in the Income-tax Act itself just after section 25(2) or by appropriate rules under the Bankruptcy law and under the Indian Companies Act that a receiver or liquidator shall within a specified period after his appointment or taking charge, give notice of that fact to the proper Income-tax authority and on hearing from him, shall set aside, out of the assets available for the payment of the tax, assets to the value of the amount notified. Such provisions are particularly necessary in the case of non-public limited companies because, in their winding up, the proceedings can be managed without any delay and with the minimum of publicity. That such provisions are nothing abnormal or out of the way will be seen from the fact that clear and elaborate provisions to that effect have been enacted in section 215 of the Australian Income-tax, 1936. A similar provision may well be introduced in the Indian Act, as it provides both for notice to the Income-tax authorities and for the obligation of the trustee to comply with any demand on behalf of the revenue as well as penalty for default. As regards the liquidation of non-public limited companies, it may also be worthwhile to introduce as part of the scheme of section 23-A provisions corresponding to sub-sections (5) and (6) of section 31 of the United Kingdom Finance Act of 1927. After providing that notices required to be served on the company shall be served on the liquidator, sub-section (5) enacts that "the liquidator shall be responsible for doing all matters or things required to be done by or on behalf of the company and the liquidator shall be responsible for the due payment of the super-tax payable by or recoverable from the company". The expanded definition of "Dividend" [section 2(6) (A) (c)] may not suffice to achieve all that the suggested provisions can achieve.

S.—Submission of Returns

(Question 28)

193. One of the principal ways of practising fraudulent evasion is when people deliberately understate their income in the Returns submitted by them, or seek to support such claim by false accounts. There are, however, many people who shrink from making a deliberately false statement, but can reconcile it with their conscience to defraud the revenue by mere passive neglect. Many send no Returns at all, hoping that either they will escape notice altogether, or that if an official assessment is made, it would be less than their real profit. At the worst, if the official assessment exceeds their real income, an appeal can always be preferred. If assessees in the top ranges of income are tempted to evade income-tax because of the steep grades of tax rates, those in the bottom ranges are tempted by the prospect that they may escape notice or detection altogether. They accordingly prefer not to make a Return. In some instances the omission to make a Return may result from carelessness, ignorance or inability to understand and correctly to fill up the form. The conduct of the assessee may thus occupy any position in the scale of dishonest practice, ranging from something only slightly less than complete honesty down to absolute fraud. The two objects to be kept in view are—

(a) to secure a Return from every person liable; and

(b) to dissuade or deter tax-payers form making incorrect Returns.

Both these purposes have to be attained mainly by coercive powers or sanctions kept in reserve, if not actually used.

194. Under the Indian Law, as it stood prior to 1939, there was no obligation on the assessee, having an assessable income, to submit a Return unless served by the Income-tax Department with a specific notice calling for a Return. The onus of notifying liability was thus not placed on the assessee and it was left to the Income-tax authorities to make an effort to gather information on the basis of which notices could be issued calling upon persons apparently liable to tax to submit a Return. Even when liability was established, the Income-tax Officer had no power of assessment beyond the current and one preceding year. This point was noticed in the Ayers Committee Report, 1936, and the Committee considered that, as in the United Kingdom, every person who had an income liable to tax should be required by law to make a Return, subject to a penalty for failure, whether or not an individual notice to make such a Return had been served upon him by the Income-tax Officer. Public notice of the requirements of the Act, they recommended, should be given by an announcement in the Press and by other suitable means, wherever necessary. They further thought that in the case of a person proved not to be liable to tax, the penalty should be exigible only if he fails to comply with the specific notice requiring him to put in a Return (see section 2, Chapter XIV of the Report).

195. In pursuance of the above recommendation, the Amendment Act of 1939 inserted section 22(1), under which it was laid down that "the Income-tax Officer shall, on or before the 1st day of May in each year, give notice, by publication in the Press and by publication in the prescribed manner, requiring every person, whose total income in the previous year exceeded the maximum amount which was not chargeable to income-tax, to furnish within such period, not being less then 60 days, as may be specified in the notice, a Return in the prescribed form and verified in the prescribed manner, setting forth his total income and total world income". Failure to submit a return in response to a general notice under section 22(1) was not made a penal offence under section

51 of the Act, but such failure was made punishable by the imposition of penalty under section 28, which lays down that where the Income-tax Officer was satisfied that any person had without reasonable cause failed to furnish a Return of his total income, which he was required to furnish by a notice under sub-section (1) of section 22, or without reasonable cause failed to furnish it within the time allowed and in the manner required by such notice, the Income-tax Officer may direct that such person shall pay by way of penalty, in addition to the amount of income-tax and super-tax payable by him, a sum not exceeding 1½ times that amount. Even this penalty is not exigible in all cases because, under proviso (a) to section 28, no penalty for such failure to furnish a Return of the total income shall be imposed on an assessee whose total income is less than Rs. 3,500, unless he has been served with a notice under sub-section (2) of section 22. The assessee was thus shewn a concession where it could be presumed that he had made a *bona fide* mistake.

196. In 1939, the maximum amount which was not chargeable to tax was Rs. 2,000, and it was presumed that the assessee could be regarded as having made a *bona fide* mistake if his income was actually found to be under Rs. 3,500. But such *bona fide* mistake could not be presumed where there was an error of more than Rs. 1,500. At present the maximum amount not chargeable to tax is fixed at Rs. 3,000, with the result that the margin of error, which the law condones, has now been reduced to only Rs. 500. We consider that instead of having to amend proviso (a) to section 28(1) every time the Finance Act changes the minimum fixed for income-tax liability, it would be desirable to make a self-adjusting provision by enacting that no penalty for failure to furnish a Return under section 22(1) shall be imposed on an assessee whose total income does not exceed the maximum amount not chargeable to income-tax by more than Rs. 1,500.

197. We have considered whether we should not have a provision on the lines of section 161 of the Australian Income-tax Assessment Act, 1936, under which "every person shall, if required by the Commissioner by a notice published in the Gazette, furnish to the Commissioner, in the prescribed manner within the time specified in the notice or such extended time as the Commissioner may allow, a Return signed by him, setting forth a full and complete statement of the total income derived by him during the year, of the income and of any deductions claimed by him". It will be noticed that under this provision it is not left to any person to decide for himself whether his income is liable to income-tax or not. But under the proviso to that section, the Commissioner has been given power to exempt from liability to furnish Return such classes of persons not liable to pay tax as he thinks fit. Any person so exempted need not furnish any Return unless he is required by the Commissioner to do so. We are of opinion that the principle of this section might, with advantage, be adopted in this country. Although in view of the prevailing state of poverty in India, it would unreasonable to call upon each and every person either to submit a Return or to obtain from the Income-tax Officer a certificate of his non-liability to income-tax, there is, in our opinion, considerable scope for loss of revenue if the liability to submit a Return was imposed only on persons who consider themselves liable for the payment of tax. Many persons may honestly believe that their income does not reach the maximum amount not chargeable to tax on the assumption that they were entitled to make certain deductions which, on scrutiny by the Income-tax Officer, may not be found to be allowable. It is thus possible that the actual income may exceed the non-taxable limit. The marginal tax-payer can thus get away and take the chance of his existence or taxability not being discovered by the officers of the Department. The advantages of such waiting tactics will, to a certain extent, be diminished by the possibility (when he is discovered) of his being taxed for several years together under section 34, and the amend-

ment recently made in the Act on our recommendation will make it even less worth his while. But to some extent the position may be remedied by adopting in principle the provision of the Australian Statute. We think, however, that instead of leaving it to the Income-tax authorities to exempt from liability to furnish Return such classes of persons not liable to pay tax as they think fit (as in the Australian Act), a definite limit may be laid down in the Statute itself, and it may be provided that the Income-tax Officer may require every person to submit a Return if his total income in the previous year does not fall short of the maximum amount not chargeable to income-tax by Rs 500. This provision, together with the suggestion we have recommended in the preceding paragraph, would allow for a margin of error of Rs. 1,500 before a person becomes subject to a penalty under section 28 of the Act, or to a prosecution under section 51 as recommended in the next paragraph. At the same time, it would enable the Department to deal with cass which the marginal assessees may honestly or otherwise regard to be exempt from income-tax, but which on examination may be found liable to pay income-tax.

198. But the real difficulty that has faced the Department is how to ensure that those who are liable to submit a Return do in fact do so. The sanction behind any requirement of law is the penalty which might be imposed for a breach of that law. We have anxiously considered whether failure to submit a Return in response to a notice under section 22(1) may not be made an 'offence'. Opinion on this point was very sharply divided, the majority, however, being of the view that it should not be made an offence punishable under section 51 of the Act. In the present state of illiteracy and ignorance, it may, perhaps, be too drastic a step to make such failure an offence. The reasons which induced the Legislature in 1939 not to make such a failure an offence and to make it punishable only with penalty under section 28 have, perhaps, not become less forcible today. But we would recommend that failure to submit a Return under section 22(1) may be made an offence if the income of the persons is found to exceed the maximum amount not chargeable to income-tax by more than Rs. 2,000. With a margin of Rs. 2,500, no honest assessee will be penalised and the dishonest assessee deserves no consideration in the way of exemption from prosecution for non-submission of a Return under section 22(1). Once an assessee has been found, in spite of the failure to submit a Return under section 22(1), there is no further difficulty as such a person would be served with an individual notice under sub-section (2) of section 22, the failure to comply with which attracts more serious consequences.

199. Many of the replies we received stressed the desirability of power being given to the Inspectorate staff to examine the books of account of potential assessees and to take sworn statements from them. We think there is a good deal to be said for having the staff armed with the necessary powers. An objection which is likely to be raised against such a proposal is that such staff might exercise their power to the harassment of the public; but we think that this objection on the score of possible harassment can be carried too far. The moment a notice under section 22(2) is served on an individual, he would be bound to submit all his accounts to the Income-tax Officer and give a sworn statement. However, in order that all and sundry may not be served with notices under section 22(2), it would be desirable to empower the Inspectorate staff to examine the accounts and to take sworn statements from persons whom an Inspector has reasonable grounds to believe to be persons with a taxable income. If the Inspector is given power to obtain a statement on oath about a person's income, it would be a potent factor in discovering new assessees, as a deliberate false statement would render the person liable to prosecution.

200. It has sometimes been suggested that a tax-payer may be indirectly compelled to make a Return or disclosure by imposing a high assessment in the dark when he has not made a Return; but this course has never been regarded as satisfactory (see Income-tax Committee Report, 1905, paragraph 28). The position will, of course, be different if year after year a person prefers to pay up what he is charged rather than make a disclosure of his true income. Such conduct may justify the inference that his income is not likely to be less than the amount for which he is assessed. The success of any provision made by law depends to a large extent upon the manner in which it is administered. Inadvertent omission to submit a Return, even if there be no reasonable cause for the failure, should be treated lightly. Reasonable and judicial discretion should be exercised in imposing penalty for failure to submit Returns, unless the case can be regarded as an aggravated one by reason of repeated failures or other special circumstances. This will ensure better co-operation between the public and the Department.

T.—Maintenance of Accounts

(Questions 29, 30 and 31).

201. One of the main difficulties facing an Income-tax Officer is that of ascertaining the correct income of the assessee. The task will be very considerably simplified if the assessee produces accounts regularly and properly kept and, if possible, audited. But in the case of many individuals, as also in the case of small business men, the plea often put forward is that no accounts worth the name have been maintained. We have, therefore, considered whether it would not be feasible to impose a legal obligation on all persons, at least on those who do business, to keep accounts. Public opinion on this point is overwhelmingly of the view that no such legal obligation should be imposed and, on the whole, we are inclined to accept this view. In the present state of illiteracy in the country, the suggestion seems to us to be impracticable. Even in England, the Royal Commission, as late as 1920, declined to recommend any such provision. They stated: "It has been suggested to us by many witnesses—and not by Accountants only—that all traders should be obliged to keep accounts. However desirable this may be in theory, we feel that it is a matter that does not lie wholly within the area of our subject, and we believe that to attempt, under cover of an income-tax provision, to attain this end might be open to misconstruction and would throw unnecessary odium on the Inland Revenue Department. It must be borne in mind that the revenue is not wholly without remedy in the case of a trader who keeps no accounts, and with improved administration and methods of assessment further information on which to base estimated assessments can be obtained. In any case, we think it would be quite impossible for the law to enfore, as an income-tax, measure, the provision that makes it compulsory on every trader in the country to keep accounts. There are traders who are quite incapable of keeping proper books, even if they have a desire to do so, and many of the small traders are exempt from income-tax". These views expressed with reference to a country so far advanced in education and business methods apply with even greater force to our country in its present state of education and adoption of business methods. We cannot, therefore, recommend provision on the lines of section 46 of the Canadian Act, which says: "If a tax-payer fails to keep adequate books of accounts for income-tax purposes, the Minister may require the tax-payer to keep such records or accounts as he may prescribe".

202. Even though it may not be practicable to impose an obligation on all assessees to maintain proper accounts, we think that the maintenance of such accounts should, wherever possible, be encouraged. One of the frequent complaints made to us was that the assessees are discouraged from maintaining accounts when they find that such accounts as have been maintained are treated

with scant respect by the Income-tax authorities. There is, perhaps, some justification for this complaint, and it would not be correct for the authorities to reject accounts merely because they have not been kept in the form which appeals to the authorities, or because some flaws are discovered in the manner of keeping accounts. In the cases of certain lines of business, e.g., Hotel keepers, Pan Bidi merchants and Sundry Provision dealers, the very nature of the business may not permit of accounts being maintained except in a very rough way. It is also possible to argue that the Income-tax Officers are sometimes tempted to reject accounts on flimsy grounds in order to be in a position to take advantage of the proviso to section 13, which says that "if the method employed by an assessee is such that in the opinion of the Income-tax Officer the income, profits and gains cannot properly be deduced therefrom, a computation shall be made upon such basis and in such manner as the Income-tax Officer may determine". We, therefore, recommend that the Central Board of Revenue should issue general instructions to the Income-tax Officers directing that every effort should be made to encourage assessees to maintain proper accounts and, unless the defects in the maintenance of the accounts disclose a desire on the part of the assessee to screen his profits from the notice of the Income-tax Officer, or they are so badly kept as to make them practically useless for the purpose of ascertaining the income, profits or gains, the assessment should as far as possible be made on the basis of the accounts maintained by the assessee.

203. The Department believes that in many instances assessees falsely assert that they do not keep accounts when in fact they do, hoping that by suppressing the accounts they can conceal their real income. Power has accordingly been asked for to enable officers of the Department to pay surprise visit to the houses of assessees or their places of business to search for account books suspected to exist and to seize them if they are available. Similar powers have been asked for in cases where the officer suspects that two sets of account books are kept, the manipulated set being produced before the officer and the genuine set kept at home or at the place of business. A power of this kind was recommended by the Ayers Committee of 1936, but the provision relating to this point in the Amending Bill was dropped when the Bill was before the Legislature. We consider that Income-tax Officers should be armed with such powers. To guard against possible misuse of such powers, we have suggested certain safeguards in paragraph 293. We also think it necessary that Income-tax Officers should have power to summon the accounts relating to years subsequent to the year of assessment because they will furnish data for checking the correctness of the previous accounts in the matter of carry over, ascertainment and distribution of profits, the manner in which particular items have been adjusted, etc.

204. We have also considered the question as to whether any provision should be made for the compulsory preservation of accounts. Most of the replies which we have received to our Questionnaire have expressed the view that there should be no such compulsory provision. But they have themselves drawn our attention to the provisions of section 34 of the Income-tax Act under which it practically becomes necessary for assessees to preserve their accounts for even 8 years as they may receive notice for revision of the assessments under that section. This being so, we think it will be no great hardship to impose legal obligation for preservation of the primary and subsidiary accounts for a period of at least 4 years.

205. In respect of accounts relating to large businesses, it will be a useful safeguard for the Department if the accounts are examined and certified by a duly qualified Auditor. A suggestion was made to us that it would be desirable, at least in the case of assessees having income above a certain level, to insist

by a statutory rule or at least a kind of convention that the accounts should be audited by properly qualified Auditors. The general trend of opinion in reply to our Questionnaire was that there should be no such legal obligation imposing compulsory audit. We are not disposed to attach much importance to the reason given in some of the replies that such compulsory audit would make the officers of the Department less careful in the examination of the accounts. But it does not seem to us right or expedient, as things now stand, to insist on audit merely for the convenience of the Income-tax authorities in the case of all business assessees. We think that the provision of compulsory audit would impose upon small or even moderate sized businesses a wholly disproportionate monetary burden. But in the case of businesses with large incomes, it would not, in our opinion, be unreasonable to require that the accounts produced by such firms should be audited by properly qualified Auditors.

206. A complaint was made to us by several firms of Auditors that the Income-tax Officers were not disposed to attach as much sanctity to an Auditor's certificate as they were entitled to expect from the authorities, and that the Income-tax Officers often required the production of account books and subjected them to prolonged examination even when the accounts were accompanied by an auditor's certificate. This criticism, in our opinion, overlooks the nature of the investigation which has to be made by an Income-tax Officer. An Auditor's certificate must, in the nature of things, be restricted to such transactions as have been brought into the books. If an item of expenditure is noted in the accounts, an Auditor can ask for the production of the receipt or voucher in support of the expenditure having been incurred. So long as such receipt or voucher is forthcoming, an Auditor does not usually look further than this; but it is the function of the Income-tax Officer to examine the reliability of those accounts, receipts and vouchers, and to satisfy himself whether the expenditure which is alleged to have been incurred was in fact incurred or not. Moreover, a dishonest assessee may wish to keep out of the accounts transactions which he wishes to conceal. It was in this manner that the transactions which resulted in black-market were kept out of the books of accounts. In some instances we found that two sets of books were maintained—one containing the correct accounts showing the real profit, and the other set meant for production before the Income-tax Officer showing profits far below the actual profits. If the Income-tax Officer is not to look beyond an Auditor's certificate in order to ascertain the real profits, we apprehend that a large amount of revenue would be lost. Similarly, we noticed in one case that expenditure was ostensibly incurred for the purchase of some stores required by a mill, but was in fact incurred on account of a director of the business, for the purchase of personal requirement and debited to the mill account. In the same case we found that elaborate instructions had been given as to how the bill was to be made out on an old paper with a particular letter press in the name of the mill for goods required by the mill and was to be sent to a particular individual who would be prepared to pass it. If such a bill was produced before an Auditor, there would be nothing in it which would arose his suspicion and the expenditure would be admitted in audit in the usual course. It has also been suggested that in the case of rich assessees, particularly of powerful companies, Auditors are obliged to depend on the good will of those in control and have to submit to limitations on the nature and extent of their investigation. But it is the business of the Income-tax Officer very often to go behind the entries made in the accounts, even though accepted by an Auditor, and to find out the real profits of the business. It may be that in respect of public limited companies the risk in accepting an Auditor's certificate is not very great, but in respect of firms and non-public limited companies we do not think that the Auditors should have any real ground for complaint if the accounts are scrutinised with some care by an Income-tax Officer even though they are accompanied by a certificate from a duly qualified Auditor. We trust we shall not be misunderstood if we

say that in their own interests Auditors will do well not to insist on any special claim or privilege till the profession has had time enough to establish its strength and tradition in this country. We have, however, no doubt that the Income-tax authorities will be grateful to have their assistance and to derive the maximum benefit from it.

207. Some of the Auditors have suggested that the Department may lay down a form in which an Auditor should give the certificate so that it may be more acceptable from the point of view of the Income-tax authorities. We recommend that the Central Board of Revenue should, in consultation with the Accountancy Board, examine this suggestion, which, if adopted, would act as an encouragement to businessmen to have their accounts audited. We understand that even now it is the practice of some auditors to certify what is the taxable income according to the Income-tax Act.

208. When the accounts have not been audited, we think that in the case of businesses a statement should be called for, showing how the profits have been arrived at from the books of account. In the form which is prescribed at present in Part IV of the Return, the first heading is "Profit or Loss as per Profit and Loss Account for the year ended . . . . . ". Then certain items are given which are to be added to or deducted from that profit or loss. But the assessee is not required to show how from his accounts the profit or loss has been arrived at. This point was considered in the Ayers Committee Report of 1936 at page 73. The following observations were made there:—

> "These, *i.e.*, the accounts are, however, frequently not balanced and in very many cases have no summarised account corresponding to a Profit and Loss account which brings out the actual profit or loss for the year. An assessee cannot perform his statutory duty of making a correct Return of his income, unless he summarises the various accounts in his books and extracts therefrom the figures of profit In practice, however, it is left to the Income-tax Officer in many cases to extract the relevant figures from the books and the assessee is not even asked for a statement showing how from his books he arrives at the figures of his Return This involves the tacit assumption that he does not take the steps necessary to enable him to make a correct Return and the burden of ascertaining the profits shown by the books is thrown upon the Income-tax Officer who thus performs what is strictly the statutory duty of the assessee."

Similarly, the Royal Commission of 1920 recommended in paragraph 632 of their report that Schedule D return form should require a copy of the tax-payer's own calculation showing how the amount returned has been arrived at.

209. In India, the head note No 2 to Part IV of the return requires that if the accounts are kept on the mercantile accountancy or book profit system, a copy of profit and loss account and balance sheet must be attached to the return and that if the accounts are kept on any other system, the name and description of the system is to be stated, and a copy of any statement which corresponds to the profit and loss account in the mercantile system must be attached to the return. But we are informed that in a large number of cases the profit and loss account does not contain the trading account of the concerns, and it is this trading account that the Income-tax Officer has to scrutinise in order to satisfy himself of the correctness of the return and, if necessary, to make an estimate where such a course has to be adopted under sections 13 and 23 of the Act. We, therefore, recommend that the note may be so amplified as to make it incumbent on the assessee to submit a return of his trading account as well.

210. It has been suggested to us that even in cases in which the accounts for a business have been audited, traders sometimes suppress the fact of the audit so as not to show the result of the audit, and make imperfect returns of their own. In order to checkmate this practice, we have considered whether it would not be feasible to require Auditors to disclose the names of the persons whose accounts they have audited. The trend of the replies to Question No. 31 of our Questionnaire was that it would be contrary to the etiquette and practice of Auditors to compel them to disclose information obtained in the course of audit, and that such insistence might even discourage the practice of getting the accounts audited. We think that these replies have proceeded on some misapprehension of the proposal which we had in mind in submitting that question for the opinion of the public. We never intended that the Auditors should be called upon to disclose any confidential information obtained by them in the course of their audit. All that we had in mind was that the Auditors should merely disclose the names of persons whose accounts they audited, so that the Income-tax authorities may be in possession of information showing which of the assessees had had their accounts audited but have not disclosed that fact in their Return for reasons which are not far to seek. Some of the replies suggested that the account books would indicate by the existence of ticks which the Auditors employ in auditing the accounts whether the accounts were or were not audited. But this argument would not be applicable where the assessees maintain two sets of account books. Two of the prominent Auditors, who replied to our Questionnaire, were of the view that there would be nothing objectionable in asking the Auditors to disclose the names of the firms whose accounts they had audited, and we think that the Income-tax Officers should have power to call upon Auditors to supply such information.

U.—Best Judgement Assessment

(Question 32, First part)

211. Under sub-section (4) of section 23, the Income-tax Officer has to make an assessment to the best of his judgment if the assessee fails to make a return as required by a notice under section 22 (2), or fails to produce accounts as required by a notice under section 22 (4), or, having made a return, fails to attend the Income-tax Officer's office, or to produce, or cause to be produced, any evidence in support of such return as required by a notice under sub-section (2) of section 23. The necessity for making what is in effect a best judgment assessment also arises under section 13 if the assessee has not regularly employed any method of accounting, or the Income-tax Officer is of the opinion that the income, profits or gains cannot properly be deduced from the accounts produced. There are inherent difficulties in making a fair computation of income in all such cases. *Ex hypothesi* the assessee is or should be in possession of all the material on which an assessment can be made. He chooses not to make a return, or produce evidence, or keeps accounts in such a perfunctory manner that no estimate of profits can be fairly deduced therefrom. We have heard complaints that estimates made by the Income-tax Officer are often wide of the mark, and in some cases savour of recklessness or vindictiveness. But the blame in such cases, in our opinion, rests primarily on the assessee who has failed to co-operate with the authorities in the making of a proper assessment. However, in view of the complaints we received, we made an enquiry under Question No. 32 of the Questionnaire as to how the Income-tax Officer should proceed in such cases, and on what basis such assessments should be made.

212. The majority of the replies stated that no change was required in the law: that under the circulars of the Central Board of Revenue and the rulings of the Courts, the methods adopted by the Income-tax Officers did not require any change. The Privy Council have laid down in the case of *Commissioner of Income-tax, Central and United provinces* v. *Laxminarain Badridas* (1937 I.T.R.170) the principles on which such assessments should be made. They say: "He (the Income-tax Officer) must not act dishonestly or vindictively or capriciously, because he must exercise judgment in the matter. He must make what he honestly believes to be a fair estimate of the proper figure of assessment, and for this purpose he must be able to take into consideration local knowledge and repute in regard to the assessee's circumstances and his own knowledge of previous returns by, and the assessment of, the assessee and all other matters which he thinks will assist him in arriving at a fair and proper estimate; and though there must necessarily be a guess work in the matter, it must be honest guess work. In that sense, too, the assessment must be to some extent arbitrary". Thus, as recognised by their Lordships, a certain amount of arbitrariness in the making of the assessments is inevitable.

213. Some of the replies that we received suggested that the practice of making progressive enhancement of assessment might, with advantage, be adopted. This point was considered by the Ayers Committee, and they advocated the use of it in cases where the assessee deliberately refrained from making returns of income in the hope that the Income-tax Officer's estimates would be below the real profits. They recognised that it was his only reply to such a course of evasion, but they sounded a warning that this practice should be confined to cases considered to be of that type, and that it should not automatically be applied to every case of a failure to render a return. We are in agreement with the view expressed by the Committee.

214. Some of the replies suggested that some effort should be made to maintain records of market conditions and of statistical data with regard to the rise of prices and such other matters, so that the Income-tax Officer may be in a position to make a fairly accurate estimate of the probable profits which might have been made in the business under assessment. We think that there is something to be said in support of this suggestion. Because in a larger number of cases the assessments are, in fact, made two or three years after the end of the accounting year. In such cases, unless some kind of record is maintained about the market conditions, it may be difficult for the Income-tax Officer to obtain reliable information of the prices prevailing at the relevant date with a view to make a reasonably accurate estimate of his income. But the availability of reliable information as to the market prices will be only one step in the ascertainment of the trader's profits. It would be necessary to know what his turnover and working expenses were. One of the replies suggested that Government should publish what the standard rate of profits for a particular business was in a particular year, and that this standard rate should be applied to the turnover as shown by the accounts of the assessee; even though the profits shown in such accounts may not be acceptable. We think that such a procedure will be vitiated for two reasons. In the first instance, when the accounts have been rejected, it may be somewhat anomalous to accept them so far as the turnover was concerned. Secondly, it is difficult to arrive at a standard rate of profits because the profits that may be made in a particular business would largely depend upon the business acumen of the person conducting that business, the stability and the goodwill which the business may have acquired during the preceding years, and even on the amount of capital invested in that business. We;

therefore, think that the application of the standard rates of profits as published by Government would not help the solution of the problems which confront the Income-tax Officer when he has to make a best judgment assessment. Another suggestion which has been made in this connection is that even if the turnover as shown by the assessee's books may not be deemed to be reliable, his figures as to the purchases of stock may be accepted and then an attempt may be made to estimate the probable profits on that basis. We are not satisfied that such a process is likely to lead to more accurate results. There are many other factors that must enter into calculations and after all a trader who is prepared to manipulate the accounts as to his sales will as easily be tempted to manipulate figures as regards his purchases.

215. We have heard complaints that the Income-tax Officers proceed to make a best judgment assessment under section 23 (4) on the slightest pretext, and very often for merely technical defaults. It has also been contended that the accounts of an assessee are rejected under the proviso to section 13 on very flimsy grounds. As we have pointed out in dealing with Questions Nos. 29 to 31, unless the defects in the accounts are such as to disclose a desire on the part of the assessee to screen his profits from the Income-tax Officer, or the accounts are so badly kept as to make them practically useless for the purpose of ascertaining income, profits or gains, the assessment should be made as far as possible on the basis of the accounts maintained by the assessee. If the accounts are not complete, an opportunity may well be given to the assessee to complete the accounts; minor mistakes may well be ignored; more leniency may be shown in cases in which accounts are produced but they are only found to be somewhat unsatisfactory than in cases where no accounts are produced or the accounts produced are found to be false. It will also be fair in cases in which the Income-tax Officer decides to reject the accounts that he should inform the assessee of his intention to do so, and give the assessee an opportunity to adduce any other materials that he may wish to adduce to help the Income-tax Officer to form a best judgment assessment. It is not unlikely that the sense of frustration caused by the wiles adopted by big business may induce in an Income-tax Officer a frame of mind to take severer measures against the smaller assessees. But this is a weakness which an Income-tax Officer must do all he can to overcome. The assessments made under section 23 (4) must not contain in them any element of penalty, because penalty can and ought to be separately imposed for adequate reasons, and the Income-tax Officer must, so far as assessment is concerned, do his best to arrive at as accurate an estimate of the assessee's profits as possible.

216. Many of the replies we received have stressed the point that in making assessments—either under section 23 (4) or otherwise—benefit of doubt must be given to the assessee. Although this principle is perfectly intelligible in the application of the criminal law which presumed that every person is innocent until he is proved to be guilty, it cannot be invoked with equal degree of cogency in the administration of the Income-tax law. So far as there is any doubt in the interpretation of the law—the benefit of the doubt must necessarily go to the assessee—as any taxing law must be construed strictly and in favour of the subject. The same argument, however, does not apply in relation to any doubt on a question of fact having a bearing on the assessment. In the nature of things, assessee is the person who has full knowledge regarding the details of his own business or income. In such cases, the Income-tax authorities may follow the principle of section 106 of the Indian Evidence Act which says that when any fact is within the knowledge of any person, the burden of proving that fact is upon him. In such cases, therefore, the benefit of any doubt, if any, must go to the revenue.

V.—Penalties

(Question's Nos. 41-45.)

217. The provisions relating to the imposition of penalty are contained in Section 28(1) of the Indian Income-tax Act. The section lays down the maximum penalty imposable where no returns to comply with notices under sections 22 and 34, or where there has been a failure to comply with notices under sub-section (4) of section 22, and sub-section (2) of section 23, or where the assessee has concealed particulars of his income, or deliberately furnished inaccurate particulars. There are certain provisos which operate to limit the exercise of this power. Under sub-section (6) of the section, the Income-tax Officer has to obtain the previous approval of the Inspecting Assistant Commissioner before imposing any penalty under the section. In practice, the Income-tax Officer, after hearing the assesee, or giving him a reasonable opportunity of being heard, as required under sub-section (3), draws up a draft order whenever he thinks that a penalty should be imposed and submits it for the approval of the Inspecting Assistant Commissioner. It the Inspecting Assistant Commissioner agrees to the imposition of a penalty, the draft order is then issued as the order of the Income-tax Officer, subject to any modifications suggested by the Inspecting Assistant Commissioner. In order to implement the undertaking to maintain a certain measure of uniformity in the penalties imposed under the Act (given in the course of the debate or the Bill which became Act VII of 1939), administrative approval, of the Central Board of Revenue or of the Commissioner, is obtained in special cases where the penalty proposed to be imposed is substantial.

218. We have received numerous complaints that the power to impose penalty is exercised by the Income-tax Officer in a somewhat arbitrary manner even though attempt has been made to secure uniformity by obtaining the statutory previous approval of the Inspecting Assistant Commissioner and the administrative approval of the Commissioner. We, therefore, framed Question No 41 in order to ascertain whether some other scheme might not be thought of which, in the event of failure to submit returns, would operate automatically. We asked whether it could not be provided in the Act that persons who had not submitted their returns should be disentitled from claiming statutory deductions or certain kinds. The general trend of opinion was against this suggestion, and we are, on the whole, inclined to agree with this view. In making the suggestion, we had in mind the practice in England where failure to submit a return automatically entails the forfeiture of allowances, which can be obtained only after a proper claim is made for them in the return. Under the Indian system, the necessity of granting some of the allowances is met by evempting from taxation income up to a prescribed limit. Whenever an assessment is made under section 23(4), the Income-tax Officer is bound to grant this exemption. The forfeiture of the other allowances may not involve sufficient penalty Moreover, the application of an automatic provision of the kind suggested would fail to take into account the difference between a variety of conceivable cases ranging from downright fraud to technical default in the submission of a return within the prescribed time. A mechanical rule of the kind suggested would attract the penalty without each case being judged on its own merits We, therefore, agree that the substitution of an automatic penalty would not operate equitably and that the discretion of the Income-tax authorities to regulate the quantum of penalty should be retained. The prior statutory approval of the Inspecting Assistant Commissioner and the administrative sanction of the Commissioner would no doubt be useful in securing uniformity and correcting any arbitrariness in the imposition of the penalty; but as we pointed out in paragraph 229 *infra* he Inspecting Assistant Commissioner's sanction should in all fairness be given only after allowing the assessee an opportunity to show cause against it.

219 It would appear from the section as it stands that the penalty for a default under clause (a) is heavier than for defaults under clauses (b) and (c); in the case of the former it is not to exceed 1½ times the tax payable, and in the case of the latter it must not exceed 1½ times the tax which would have been avoided if the income returned had been accepted as the correct income. In effect, therefore, a person who neglects or fails to submit a return is made more severely punishable than one who submits a return concealing particulars of his income, or deliberately giving inaccurate particulars An element of fraud is involved in the latter default and yet he is made more lightly punishable than one who fails to submit a return. This position is unsatisfactory, and this has been recognised to be such by Government. In pursuance of an undertaking given in the Legislature, the Central Board of Revenue issued a circular (No. 37) in 1939 in which executive instructions were given that the penalty under clause (a) should not exceed 50 per cent. of the tax payable, and that under clause (b) it should not exceed 50 per cent. of the tax which would have been avoided had the income returned been accepted as the correct income, subject, in either case, to a minimum penalty of Rs. 25. No such instructions have been given so far as penalty under clause (c) is concerned. We consider that the matter should not be left to executive instructions and that the section itself should recognise in the penalties prescribed the degree of delinquency involved in the various defaults enumerated in section 28. Under section 328 of the draft Bill prepared by the Codification Committee in England, the penalty for failure to deliver return required by a notice given in pursuance of any of the sections enumerated therein is a sum not exceeding £50 and a further penalty not exceeding £10 a day for the period during which the failure continues after the judgment has been given for that penalty. As section 28 of the Indian Act makes no provision for continuing default, the penalty by way of a specified sum may not in the case of big assessees, prove to be adequate. We, therefore, recommend that the penalty under clause (a) may be 25 per cent. of the tax payable.

220. The penalty under clause (b) is computed with reference to the tax which would have been avoided if the income returned by the assessee were accepted as the correct income. Here, again, we think that the degrees of guilt in respect of defaults contemplated under clauses (b) and (c) are not the same, and we, therefore, recommend that the penalty under clause (b) may be equal to the tax which would have been avoided if the income returned had been accepted as the correct income.

221. Under sub-section (1)(c) of section 28, an assessee becomes liable to a penalty if he has concealed the particulars of his income, or deliberately furnished inaccurate particulars of such income. A question has been raised whether it would not be right to insist on a stricter standard in respect of the liability of assessees to discharge their statutory duty of submitting correct returns. It has been pointed out in several of the replies to our Questionnaire that it cannot be predicated with any degree of accuracy as to what "a correct return" is. A return may be correct so far as it goes, but it may contain a claim for allowances which may be found to be legally untenable. Such a return can hardly be regarded as incorrect merely because it proceeds on a wrong interpretation of the law. On the other hand, a return may contain incorrect particulars due to very gross negligence in preparing the return, and it is possible to contend that, when the statutory liability of submitting a correct return is imposed by law, the person discharging the duty should bring to bear upon his task a reasonable degree of care and caution. The law, as it stands, penalises the inclusion of inaccurate particulars only when such particulars have been deliberately furnished. The use of the word "deliberate" imports a certain measure of faudulent intention in the mind of the assessee, and when we drafted our Question No. 42, we intended to enquire whether penalty should

be imposable only where there was a definite proof of fraudulent intention in the submission of the incorrect return. We would in this connection refer to section 80 of the Canadian Act under which "any person making a false statement in his return shall be liable on a summary conviction to a penalty not exceeding $10,000 or 6 months' imprisonment, or both fine and imprisonment." The section requires that the statement should in fact be false and not that it should be false to the knowledge of the assessee. At page 256 of the law relating to income-tax in the Dominion of Canada, by Plaxton, the following observations occur:—

> "Although the use of the word 'false' in the provision suggests possibly that there must have been an intention on the part of the defendant to deceive, it should be remarked that offences against Revenue Acts, which may be described as quasi crimes, ought to be disinguished from the offences against the Criminal law, inasmuch as the purpose of the provisions of a Revenue Act is to protect the revenue, and consequently the intention of the offender is of little importance. The proof of the untruth, however, undoubtedly shifts onus on the defendant to show that the untrue statement was made without an intention to defaud the revenue and without negligence."

Further, comparing the words of section 28 (1), under which penalties are imposed, and of section 52, under which an assessee may be prosecuted (and even sentenced to imprisonment), we find a somewhat noticeable difference. Under section 52, which may be regarded as the more severe of the two, a conviction can be obtained in the case of a return which is in fact false, not only whom the assessee knows or believes it to be false, but also where he does not believe it to be true. Where an assessee knows or believes any statement to be false, he can be said to have made a deliberately false statement within the meaning of section 28 (1). But section 52 is wider, inasmuch as it punishes an assessee also when he does not believe any statement made in a verification to be true, even without knowing or believing it to be false. A person may not believe a statement to be true without knowing or believing it to be false. He may not have taken sufficient care to ascertain whether the statement is true or not. If an assessee can be prosecuted and sentenced to imprisonment for having made a statement recklessly, then *a priori* there is no sufficient reason to protect him from the imposition of a penalty under section 28. As the law stands at present, it is only deliberate furnishing of inaccurate particulars which attracts the imposition of a penalty, and the responsibility of satisfying himself that the inaccurate particulars have been deliberately furnished lies on the Income-tax Officer.

222. We do not recommend that the element of *mens rea* should be done away with altogether. It is true that Plaxton's view, in the quotation given above, is that the proof of untruth should shift the onus on the assessee to show that the untrue statement was made without intention to defraud the Revenue and without negligence and that this view obtains recognition in section 146 (1) of the English Act of 1918. Under that section if the General Commissioners have come to the conclusion that the tax-payer's income is greater than was shown in his return, there is thrown upon him the burden of proving that his omission did not proceed "from any fraud, covin, art or contrivance, or any gross or wilful neglect". Failure to discharge this onus renders him liable to pay a sum not exceeding treble the amount of tax on the amount of the excess. But the Income-tax Codification Committee (1936) has characterised this section as a "flagrant departure from the principles of British penal jurisprudence". In view of this criticism we recommend the adoption of a less objectionable formula on the lines of section 329 and section 330 of the draft prepared by the Codification Committee, *viz.*,

Section 329. "Any person who, being required to deliver a return......... delivers a return which is incorrect or incomplete in any material particular shall—if he acted negligently—be liable to a penalty............"

Section 330. "Any person being required to deliver a return......delivers a return which is incorrect or incomplete in any material particular shall, if he acted fraudulently, be liable to penalty......

The penalty proposed under section 330 is higher than that proposed under section 329. This proposal is in accordance with the law in U.S.A. embodied in section 293 (see Codification of Internal Revenue Laws, p. 88). That section is in the following terms:—

"*Negligence*: If any part of the deficiency is due to negligence, or intentional disregard of rules and regulations but without intent to defraud, 5 per cent of the total amount of deficiency (in addition to such deficiency) shall be assessed, collected and paid in the same manner as if it were a deficiency.........

Fraud: If any part of the deficiency is due to fraud with intent to evade tax, then 50 per cent of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected and paid............"

The basis for this distinction is explained as follows in Shultz's "American Public Finance", 3rd Edition, p. 459:—

"Innocent understatement of income on a tax return is rarely punished—the tax laws being content with an interest payment on the deficiency. Where 'negligence' is established as the cause of understatement, the interest charge is usually higher. Fraudulent understatement is punished even more severely."

There are one or two other points arising out of the wording of section 28 as it stands at present which require consideration. Under section 28, the power to levy a penalty is conferred on the Income-tax Officer, the Appellate Assistant Commissioner and the Appellate Tribunal. Before 1939, the Commissioner also possessed the power under this section, but it was omitted in the amendment Act, apparently because, at that time, not only was the Appellate Tribunal introduced, but even the Commissioner's powers of revision were taken away. Whether the introduction of a restricted revisional power by section 33-A called for the restoration of the Commissioner's power under section 28 or not, we think that with the enlargement of his revisional powers under section 33-B added in 1948, the restoration of the Commissioner's power under section 28 is also called for. We, therefore, recommend that the Commissioner may also be included among the authorities enumerated in section 28, sub-section (1), as competent to impose a penalty.

224 It has come to our notice that section 28 (1) has been interpreted in a manner which makes it impossible in certain circumstances to impose penalties in cases falling under section 28 (1) (c). While the assessment proceedings are pending the default referred to in clauses (a) and (b) undoubtedly comes to the notice of the Income-tax Officer and can be suitably punished; but more often than not the concealment of particulars of income and deliberate furnishing of inaccurate particulars may come to his notice long after the proceedings have been closed. In such cases the Income-tax Officer usually takes action under section 34. In furnishing a return in response to a notice under that section, the assessee may give the correct particulars and be duly assessed on a higher income. In such cases it has been held by the Allahabad High Court (see *Mayaram Durga Prasad* vs. *C.I.T. United Provinces* 5 I.T.C. 471) that the asessee is not liable to be penalised for concealing particulars or deliberately furnishing inaccurate particulars. The reason is stated

to be that the original proceedings which ended in the assessment were closed and were no longer before the Income-tax Officer and the subsequent proceedings taken under section 34 were fresh proceedings in respect of the escaped income. These two proceedings were considered to be distinct and as, *ex-hypothesi* there was no default in section 34 proceedings, no penalty could at the later stage, be imposed for anything done in the course of the earlier proceedings. Reliance was placed on the use of the present perfect tense, *viz.*, "has concealed or has furnished". Thus, unless the concealment of income or deliberate furnishing of inaccurate particulars comes to the notice of the Income-tax Officer while the original proceedings are pending, the default goes unpunished. We doubt if this could have been the intention of the Legislature. The view of the Allahabad High Court has been dissented from in the latest decision of the Madras High Court in *C. Govindraju Iyer* vs. *C.I.T., Madras* (1948 III M.L.J. 436). The learned Judges held that there was nothing in the language of section 28 which prevents an Income-tax Officer, if he is satisfied in the course of a proceeding under section 34 relating to a particular period of assessment that default has occurred at the earlier stage, from levying a penalty. They thought that the two proceedings were not distinct and that proceedings under section 34 in essence related, either partially or wholly, to the proceedings which must be deemed to have been commenced with the first notice under section 22. In their opinion there was no justification for artificial separation of the two proceedings so long as they all relate to the same assessee and to the same period. The Court emphasised the use of the word 'any' in the expression "in the course of any proceedings under the Act" in section 28 and held that the expression would include section 34 proceedings, provided they related to the same assessee and to the same period. In *Guru Prasad Shaw* vs. *C.I.T., Bengal* (1944 I.T.R. 233), the question was discussed in a slightly different form, *viz.*, whether even the notice of contemplated proceedings under section 28 should be given before the Assessment Order is passed, or might be given later. Their Lordships held "it is sufficient under the provisions of section 28 that he (Income-tax Officer) should be satisfied during the course of the proceedings, and that there was nothing in section 28 from which it can be said that the notice under sub-section (3) must be given before the conclusion of the assessment". We are inclined to think that the broad view in the Madras case should be followed. In order that there may be no room for doubt, we recommend that the section may be suitably amended so that penalty under section 28(1) (c) may be imposed even if the circumstances attracting the operation of that provision are discovered after the proceedings, in the course of which the misconduct occurred, have been closed, and proceedings taken under section 34 may, for the purpose of section 28(1)(c), be regarded as a continuation of the original proceedings.

225. Apart from the anomalies arising from the wording of section 28, we have considered how the section has been worked in practice and whether any improvements could be suggested in the manner in which it is put into operation.

226. In Question No. 45 we made inquiries whether any suggestions could be made as regards the exercise by the Income-tax Officers of the powers under section 28. Many of the replies made a general comment that the power was not exercised judicially, but that penalties were imposed mainly with the idea of benefiting the revenue. Some replies even went to the length of saying that severity in the matter of imposition of penalty was recognised by the Department as a merit in the officer concerned and that thus indirect encouragement was given to this undesirable procedure. They recommended that penalty should be levied only where there was a deliberate attempt to defraud. We agree that the imposition of penalty should not be merely

mechanical, and that judicial discretion should be exercised in the matter. To quote again from Shultz's book at page 330: "Honest, consistent and expeditious administration, it has been found, will secure voluntary observance of tax laws from most tax-payers. Among this majority are many tax-payers who make mistakes through innocent ignorance or carelessness. They should be treated with lenience. Some occasionally succumb to venturesome impulses and seek to "to put on" a little cheat on the Tax Bureau, and finally there are always "tax outlaws", who will wilfully evade any and every tax if there is a chance that their evasion will succeed. For the last two classes there must be tax penalty, mild for the venturesome, suitably severe for the outlaws".

227. The requirement of the law that penalty should be imposed with the previous sanction of the Inspecting Assistant Commissioner is designed to secure that a maturer judgment is brought to bear on the subject, and we trust that the Central Board of Revenue will impress on the Commissioners and the Inspecting Assistant Commissioners this aspect of the matter. As the previous sanction of the Inspecting Assistant Commissioner is made obilgatory by law, we trust that the power to impose penalties will not be lightly exercised, especially if it is the first default of the assessee. It must be borne in mind that the law lays down only the maximum penalty in a particular case, but each case should be treated on its merits and the penalty must be commensurate with the degree of delinquency involved. Here we may quote with advantage observations in paragraph 630 of the Report of the Royal Commission on Income-tax of 1920. They say: "Experience teaches us, on the one hand, that to ensure the success of any tax the public must have confidence that the law is impartially and firmly administered and that evasion and fraud are carefully guarded against and severely punished when discovered. On the other hand, it is equally vital to abstain from acts and methods that would hamper or irritate industries and make the tax so unpopular as to destroy the general goodwill which is essential if the tax is to yield its full quota to the revenue". Some of the replies suggested that a graded penalty should be laid down. Apart from the difficulty of classifying various defaults into different grades, we may note that the section itself is a self-adjusting one as it links the penalty—varying with the kind of default—with the assessable income.

228 Some replies recommended that the penalty for non-compliance of a notice to submit a return should not be imposed if the return was in fact submitted before the end of the financial year. If this suggestion were adopted in all its generality, we apprehend that most of the returns will not be submitted till the end of the year, and that the period for the submission of such returns fixed by law or in the notice from the Income-tax Officer will be ignored with impunity. Cases are however conceivable that possible assessees may not realise their obligation under section 22(1) in sufficient time to file their returns within the period specified in section 22(1). If later in the year they become aware of their obligation, they may be tempted to keep themselves back in the hope that their assessability may not become known to the Department, whereas if they honestly come forward and make a return, though after the expiry of the prescribed date, they may attract not merely liability to tax but also liability to penalty. The mere possibility that even if they do not come forward, they may be found out later and proceeded against under section 34 is only a contingency. Both in the interest of the assessee and the Department, it seems to us worth while to encourage the honest defaulter to come forward even if it is after the expiry of the notice date and file a return *suo motu*. To this end we would recommend that

after or before proviso (a) to section 28(1), a proviso to the following effect may be inserted:—

"No penalty for failure to furnish a return in response to notice under section 22(1) shall be levied if, before the issue of a notice to him under section 22(2), a person delivers a return as required under section 22(1), and the Income-tax Officer is satisfied that the omission to furnish the same within the prescribed period was due to ignorance, mistake or other sufficient cause."

229. Apart from making general comments, some of the replies made one or two specific suggestions. It was pointed out that the assessee had no opportunity of being heard when the sanction of the Inspecting Assistant Commissioner was obtained for the imposition of a penalty. We think that there is good deal of force in this criticism. The usual procedure is that after hearing the assessee on a notice under section 28(3), the Income-tax Officer, if he is of the opinion that a penalty should be imposed, draws up a draft order for the approval of the Inspecting Assistant Commissioner. The assessee has no opportunity of persuading the Inspecting Assistant Commissioner that it is not a fit case for imposing penalty, or that the penalty proposed to be imposed is excessive. The draft order is not available to the assessee for the purpose of ascertaining whether all his arguments have been noted and considered. In many cases the prior administrative approval of the Commissioner is obtained—formerly even the Central Board of Revenue used to be consulted. It is true that the assessee can appeal to the Appellate Assistant Commissioner against the order levying penalty, but the assessee, not unnaturally, thinks that the Appellate Assistant Commissioner would be slow to disturb the order of the Income-tax Officer when he knows that it has received the imprimatur of not only the Inspecting Assistant Commissioner, as required by the statute, but also that of the Commissioner, and sometimes of the Central Board of Revenue. The assessee may legitimately feel that in such a case his appeal is for all practical purposes infructuous. Even when the matter is taken to the Appellate Tribunal, and the latter asks for a report from the Income-tax Officer, the report, we are informed, is treated as confidential and is not available to the assessee. We think, therefore, that before giving his approval to the imposition of a penalty, the Inspecting Assistant Commissioner should give an opportunity to the assessee of being heard and if, after hearing him, he gives his consent to the order of penalty proposed to be passed by the Income-tax Officer, the appeal against such order should lie direct to the Appellate Tribunal. If our proposal that the Appellate Assistant Commissioner should be made independent of the Department and placed directly under the Ministry of Law is accepted, then we see no harm in the appeal being preferred to the Appellate Assistant Commissioner as at present.

230. Another point urged in the replies to our Questionnaire was the manner in which section 28 was interpreted. According to the section where an Income-tax Officer discovers an item which has been concealed, the penalty is levied at $1\frac{1}{2}$ times the tax which would have been avoided if the income returned had been accepted as the correct income. It has been argued that the assessed income might have been arrived at on considerations not related to the concealed item and often by reason of the disallowances of certain claims made in the return, and that in such cases the penalty usually levied bears no relation to the concealed item. In support of the existing practice it can be argued that the rate of $1\frac{1}{2}$ times the tax which would have been avoided is only a measure for arriving at a figure of the penalty to be levied for the default, irrespective of the magnitude of the default. On the other hand, it can also be contended that the law, as it stands, seeks to impose penalty at a prescribed

rate on the income which the assessee is deemed to have attempted to conceal. It has to be remembered that the difference between the assessed income and the returned income may not be solely due to attempted concealment of income but may also be due to ignorance of law, miscalculation, etc., which might have resulted in the lower amount of income being stated in the return. In our opinion, the penalty should, as far as possible, be related to attempted concealment. In cases where the accounts are accepted, the concealed income may be of two kinds—concealment of a source or item of income, or concealment through disguised expenses. In arriving at the assessable income, the Income-tax Officer adds back what he considered to be concealed items to the sum of returned income and statutorily inadmissible items. In such cases, the Central Board of Revenue's Circular No. 40 of 1941 directs that for the purpose of arriving at a quantum of penalty, the following method may be adopted.—"Where the accounts are not rejected but the assessable income is determined by adding back inadmissible items in addition to the income concealed or estimated to be concealed, penalty should be computed by taking the difference between the tax on the income assessed and the tax on the income declared as increased by the inadmissible items added back in respect of which an honest difference of opinion could be entertained. No relief need necessarily be given, however, in respect of such items which the assessee ought to have added back according to the instructions in the return form." This seems to us to be a fair method of computing penalties as it is essentially related to the items attempted to be concealed. Where the accounts are rejected as incomplete and unreliable as a result of the discovery of concealed income and the assessable income is determined by an estimate, the circular directs "that the estimate should be presumed to be as near the actual income as is possible of ascertainment and the amount of penalty calculated taking difference of tax on the income declared and on the income so estimated". While the rule thus stated may not be open to objection, there is a danger of its being applied even to cases which should properly be held to be governed by the previous rule. Income-tax Officers must carefully consider whether a case is merely one of concealment of a particular item or items or the concealment which they may discover is such as to suggest that the accounts are unreliable and should be rejected. Though the discovery of concealment may be a common factor to both cases, the two cases obviously belong to different categories for the purpose of penalising the assessee. We would, therefore, suggest to the Central Board of Revenue that the circular may be suitably modified so as to bring these considerations clearly to the notice of Income-tax Officers.

231. It not infrequently happens that the Department has the choice of an alternative remedy in the case of income-tax offences. Failure to make a return or to comply with notices contemplated in section 28 (1) (a) and (b) of the Act can not only be punished by the imposition of a penalty under that section, but can also be made a ground for prosecution as far an offence under section 51 of the Act. The delinquency referred to in section 28 (1) (c) can be punished either by means of a penalty under that section, or by a prosecution under section 52 of the Act. A person who submits a return which conceals particulars of his income, or furnishes deliberately false particulars, has to make a verification which will *ipso facto* be false, and the false statement in such a declaration is an offence under section 52. Sub-section (4) of section 28 lays down that no prosecution for an offence against the Act shall be instituted in respect of the same facts on which a penalty has been imposed under that section. Sub-section (2) of section 53 gives powers to the Inspecting Assistant Commissioner to compound any offence, either before or after the institution of proceedings under sections 51 and 52.

232. The policy of the Department hitherto has been generally to adopt the remedy of levying penalties under section 28. In those cases in which prosecution has been, or is intended to be, resorted to under section 51 or section 52, the matter is usually compounded and only a few cases are pressed to conviction. Both in the case of levying a heavy penalty and in cases of prosecution and consequent compounding, if any, the orders of the Central Board of Revenue are generally obtained.

233. We wanted to assess public opinion on the proper procedure which should be adopted in such cases, and we enquired (see Question No. 44) whether Government should ordinarily proceed to prosecute the person concerned, or preferably safeguard the revenue by the imposition of a penalty under section 28, or by compounding the offence. We also asked whether the maximum penalty under section 52 should not be increased if the possibility of a prosecution is to serve as a deterrent. We made enquiries as to what the public reaction would be

(i) if there are frequent prosecutions for income-tax offences; and

(ii) if even clear cases of offences are compounded.

234. The replies we received disclosed very great divergence of opinion. While a few suggested that prosecution should invariably be resorted to, a large majority were in favour of imposition of a penalty or of compounding of offences. These latter pointed out that the standard of proof required for a conviction in a criminal Court is very high and there is not altogether negligible danger of the person being acquitted merely on technical grounds. Failures in prosecution, even though they be on technical grounds, would be damaging to the prestige of the Department. Some others preferred to follow a middle course, and said that the first two or three defaults may be dealt with under the penalty section but that later lapses should invariably result in a prosecution or at least in the imposition of a very heavy composition fee. Some replies pointed out that composition in clear cases would give rise to serious misgivings in the mind of the public, especially when cases against persons of substantial means are compounded and those against poor persons are pressed to conviction. Some of the replies agreed that the maximum penalty imposable under section 52 should be increased.

235. We think that normally the procedure by way of levying a penalty under section 28 should be followed. Penalty is essentially meant both as a corrective and a punishment to the delinquent. Prosecution is intended to serve not only as a punishment to the person concerned, but is also designed to act as a deterrent to others. There are considerable difficulties in the way of securing a conviction in a Court of law, and even a really good case may fail for technical reasons and persons who are morally guilty might thus escape. Government would in such cases not only lose revenue, but may sustain some damage to the prestige of the Department. Government cannot afford to risk too many failures. As has been pointed out by Shultz in American Public Finance, page 330: "To make tax evasion a criminal act punishable by heavy fine or imprisonment is a punishment which generally fails through over-severity. On this ground jury has persistently refused to convict a person indicted for tax evasion.........Punishment for evasion should take the form of monetary penalty specifically provided by the tax statute".

236. At the same time the efficacy of a prosecution as a deterrent cannot altogether be ignored, and we think that in suitable cases prosecution should be undertaken. In our view, it should be resorted to in flagrant cases, or in cases

of repeated violation of law, where the imposition of penalty has had no effect, or where the amount involved is large. In order that the prosecution under section 52 may have a more deterrent effect, we recommend that the section should differentiate between the less serious and more serious offences, and that in the case of the latter imprisonment should be made either simple *or rigorous* and the limit of fine may be extended to Rs. 10,000. Unless the case is a gross one, compounding may be resorted to, but the policy should, as far as possible, be uniform so that no occasion should arise for the criticism that a rich man can, if found out, purchase his freedom by payment of money, while a poor man has to go to jail. The sanction of the Central Board of Revenue should invariably be obtained both for prosecution and for composition so as to maintain uniformity of treatment. Unfortunately, public opinion in our country is not so advanced as to look down upon those who are proved to have attempted fraud on the revenue. We are aware of cases where persons who have been prosecuted, but who have paid composition fee, are allowed to mix freely in respectable society without the public attaching any kind of moral stigma to their character and doings. We, therefore, suggest that those on whom a penalty has been levied more than once for offences under section 28(1)(c), or who have been convicted in respect of more serious offences under section 52, should be held to be disqualified or membership of legislative or local bodies or for acting as trustees, unless Government in special cases agrees to set aside the disqualification. We also recommend that the operation of section 54 of the Act may to this extent be excluded where; with the sanction of the Commissioner, the fact of an assessee having been subjected to a penalty under section 28(1)(c) has to be made public. No such provision is necessary in the case of a conviction under section 52, as the criminal proceedings are normally public The Royal Commission in 1920 have quoted with approval in paragraph 664 of their report, a statement made before them by an experienced an eminent lawyer: "People should be made to understand that if they defraud the revenue, they are committing a mean and despicable offence against every one of their fellow taxpayers and on conviction the offender should be made to feel the ignominy and disgrace attaching to the crime he has committed".

237. In considering the question of penalties for the submission of incorrect returns, we had also to bear in mind the fact that many of the assessees the assistance in the preparation of the returns from various persons, and the question naturally arose whether it would not be advisable to visit the abetment of the submission of incorrect returns with some kind of punishment, either by the imposition of a penalty or by making it an offence. In England, under subsection (2) of section 30 of the Income-tax Act of 1918, "the person who knowingly and wilfully aids or abets any person in committing an offence under that section, forfeits a sum of £50". That section refers "to a person who in making a claim for, or obtaining any allowance or deduction

(a) is guilty of any fraud or contrivance; or

(b) fraudulently conceals or untruly declares any income or any sum which he has charged against or deducted from, or is entitled to charge against or deduct from any person; or

(c) fraudulently makes a second claim for the same cause."

238. In answer to our Question No. 43, enquiring whether it would not be right to follow the English law and declare even abetment of submission of incorrect returns to be an offence, the opinions expressed were somewhat divided. Some, including some of the Auditors and Registered Accountants, were in favour of the proposal. A large number expressed themselves as being opposed to it. The latter pointedly invited our attention to the difference in the standard of education and literacy between England and India, and stated that if the

proposal made was given effect to a large number of semi-literate persons, such as clerks and munims, would be made punishable for having abetted the submission of an incorrect return. Others stressed the fact that in many instances the return is submitted under the guidance and advice of Lawyers and Registered Accountants who have perforce to be guided by the information given by the assessee. They made a special mention that so far as the Registered Accountants are concerned, they are already subject to the disciplinary jurisdiction of the Accountancy Board and that the Lawyers are under the disciplinary jurisdiction of the Bar Councils, in case they are found to have been guilty of misconduct. They stated that the only persons who guide the assessees professionally, but are not subject to the disciplinary control of any body regulating the conduct of their profession, were the Income-tax Practitioners. Other replies to our question made the suggestion that the matter should be left to be dealt with under the existing Criminal Law and that no special provision was necessary as was contemplated in the question. We are not impressed by any of these arguments.

239. Taking the last-mentioned objection first, if the matter were left to the existing Criminal Law, a person would be convicted of abetment only of an offence under section 52 of the Act. That section, however, refers to the making of a false statement by the individual concerned in a verification required to be made under different sections of the Act. What we had particularly in mind was the abetment of the submission of an incorrect return which is mentioned in section 28(1) (c) of the Act. That, however, is a lapse punishable only with a penalty under the Income-tax Act, and the existing Criminal Law will not make the abetment of that lapse punishable, unless specific provision to that effect were made. It is true that the standard of education and literacy in this country is not as high as it is in England; but a person would render himself liable for punishment as an abettor only if he "knowingly and wilfully assisted" another person to submit an incorrect return. That would be a question of fact to be decided in the circumstances of each case, and we have no doubt that the persons authorised to impose a penalty would take into consideration whether, having regard to the standard of education of the person alleged to be guilty of the abetment, he could properly be said to have knowingly and wilfully helped the assessee in submitting an incorrect return. We are aware that Registered Accountants and Legal Practitioners are subject to the disciplinary jurisdiction of the Accountancy Board and the Bar Councils respectively, but the power of taking disciplinary action has, so far as our knowledge goes, been exercised extremely rarely, if at all. The procedure laid down in taking disciplinary action is an elaborate one, and the infrequency of such disciplinary action does not necessarily indicate that there have been no lapses on the part of these persons. No doubt in many cases they have to be guided by the information given by the assessees themselves, and, in so far as their advice is based on the information given by the assessees, they could not be said to be wilfully and knowingly guilty of abetment. But there may be cases where complicity of the legal and accountancy advisers may be obvious, and it is in such cases that we propose that the Income-tax Officer should have power to impose a penalty.

240. The case of Income-tax Practitioners stands on a somewhat different footing, and we had numerous complaints about the competency of these gentlemen to represent the assessee in Income-tax proceedings. Under section 61 (2) (iv) of the Act, an Income-tax Practitioner means—

(a) any person who, before the 1st day of April 1938, attended before an Income-tax authority on behalf of an assessee otherwise than in the capacity of an employee or relative of that assessee;

(b) any person who has passed any accountancy examination recognised in this behalf by the Central Board of Revenue; or

(c) any person who has acquired such educational qualifications as the Central Board of Revenue might prescribe for the purpose.

The Central Board of Revenue has, under Rule 46, prescribed the educational qualifications as possession of a degree in Commerce, Law, Economics or Banking of any of the Universities specified in that rule. Some of the replies to our question suggested that it was the Income-tax Practitioners who could—if at all—be said to be concerned in abetting the commission of offences under the Income-tax Act. They are not bound to audit the accounts and can always claim to have drawn up the return on the basis of the material furnished by the assessee. They do not often sign any statements prepared by them. An Income-tax Practitioner who is qualified to be so under section 61(2)(iv)(a) of the Act need not possess any qualifications at all, except that of having attended once before an Income-tax authority prior to 1st April 1938. A person qualified under (b) of that clause may possess some accountancy knowledge, but need have no acquaintance with the Income-tax Law. A person qualified under the educational qualifications prescribed by the Central Board of Revenue, such as a graduate in Law, may be acquainted with the Income-tax Act but has no knowledge of accountancy. A graduate in Economics may have no knowledge either of accountancy or of law. Yet all these persons are entitled to represent the assessee as "Income-tax Practitioners". It has been urged that this category of Income-tax Practitioners may be allowed gradually to die out as the legal and accountancy professions can provide all the assistance that an assessee may stand in need of. We suggest that the Central Board of Revenue or the Commissioners should draw up a list of persons who are at present entitled to appear as Income-tax Practitioners by reason of possessing qualifications under section 61(2)(iv)(a) of the Act, and of those at present qualified under section 61(2)(iv) (b) and (c), provided that the latter pass an examination in Income-tax Law and Accounts similar to that prescribed for the Income-tax Officers. No further addition need be made to that list, unless the person who proposes to practise as an Income-tax Practitioner passes such an examination. All the Income-tax Practitioners having their names on the roll maintained by the Commissioners or the Central Board of Revenue, as the case may be, should be required to conform to a code of professional conduct and discipline prescribed by the Central Board of Revenue.

241. It seems to us right that we should adopt the English practice and add a sub-section to section 28 so as to provide that a person who wilfully and knowingly abets any person who has rendered himself liable to a penalty under circumstances mentioned in section 28(1)(c) of the Act, may be ordered by any Income-tax Authority to pay a fine which may extend to Rs. 500. As in the case of any other penalty, we suggest that there should be an appeal against the imposition of the penalty on the abettor. The appeal should be heard along with the appeal, if any, against the assessment in the proceedings which resulted in the imposition of penalty on the abettor.

W—Secrecy and Publicity

(Questions 46 and 47)

242. A suggestion was made to us that the provisions of section 54 may be relaxed in certain cases which are more or less analogous to the exemptions mentioned in sub-section (3) of that section. We accordingly enquired (*vide* Question No. 46) what the views of the public were regard to the disclosure of confidential information—

(1) to the Advocate-General, where it appeared that there had been a breach of trust relating to charity;

(2) to the Provincial Government in respect of information having a bearing on the recovery of Sales Tax; and

(3) to the proper authorities when the assessee makes, in the course of income-tax proceedings, statements which implicate him in a criminal offence and when such statements have been made with a view to escape liability under the Income-tax Act.

We further asked whether the statements made by an assessee in the course of income-tax proceedings may not be disclosed to a third person if such a statement asserts, falsely and with a view to escape or reduce taxability of the profits of a certain property, that such property belongs to such third person. This last proposal was similar to the provisions contained in section 7 (4) of the Income-tax (Investigation Commission) Act. The idea underlying this provision in the Income-tax (Investigation Commission) Act was that the possibility of a disclosure being made to a third party, who may be in a position to take advantage of the false statement made by the assessee may act as a deterrent against the assessee recklessly making such false statements.

243. The replies we received disclose a sharp difference of opinion. While a large number were in favour of the suggestions, the majority were not inclined to accept them. The main argument advanced by the latter was that it would be a violation of the principles of secrecy which attach to the income-tax proceedings. While some considered that it would be immoral to disclose information given in confidence to the Income-tax Department, others stressed that the practical result of such a proposal would be to deter assessees from making a true disclosure and would add to the difficulties of the Department in obtaining information. Some of the replies went so far as to say that it was no business of the Department to act either as a C.I.D. agency for other departments or as a guardian of the morals of the people.

244. With regard to the proposals contained in clauses (1), (2) and (3) of Question No. 47, we are not impressed by the arguments advanced against the acceptance of those proposals. Section 54 has for its object the maintenance of secrecy of the financial affairs of the assessee as disclosed in the assessment proceedings, except for the purposes specified in clauses (a) to (m) of sub-section (3) of that section, which are all purposes of a public nature. All statements made by the assessee and all returns furnished by him, or accounts or documents produced by him, or any evidence given by him are treated for all other purposes as confidential and they cannot be called for in a Court of law. The principle underlying the section is to make the information confidential as between the assessee and the Department so as to encourage assessees to make a full and true disclosure to the Department of all the relevant facts within his knowledge, with the assurance that any statement made by him would not be subsequently used against him. It is true that the principle of secrecy and confidence attaching to the income-tax proceedings is not to be lightly violated, but it is equally important that these principles should not afford a cloak to the assessee to make reckless statements in order to avoid tax liability with the assurance that such statements will not involve him in any serious consequences. The exceptions mentioned in sub-section (3) of the section were designed with this end in view, and it seems to us that the proposals contained in clauses (1), (2) and (3) of Question No. 46 are similar in nature to the exceptions recognised under sub-section (3). For instance, clause (j) of sub-section (3) permits disclosure to an officer of the Provincial Government of such facts as may be necessary for the purpose of enabling that Government to levy or realise any tax imposed by it on agricultural income. This provision is indistinguishable in principle from the proposal contained in clause (2) of Question No. 46, where it has been suggested that the information having a bearing on the recovery of the

Sales Tax may be disclosed to an officer of a Provincial Government. With regard to the suggestion in clause (1) of Question No. 46, it has to be remembered that income from property held in trust for charitable purposes is made exempt from income-tax for the purpose of giving encouragement and help to such trusts. It is true that it is not the business of Income-tax Officers to find out whether the income has in fact been utilised for charitable purposes, but cases are not infrequent where it does come to the knowledge of the Income-tax Officer that the income though received ostensibly for a charitable purpose, is not in fact so utilised. It is not within his power to disallow the exemption which is granted by law merely on the ground that there has been a breach of trust in the matter of utilisation of the income of the trust property. But it seems to us very desirable in the public interest that any fact discovered in the course of income-tax proceedings clearly indicating that there has been a breach of trust relating to a charity should be brought to the notice of the Advocate-General, so that, if so advised, the Advocate-General may take suitable steps in the matter.

245. There has been considerable opposition to the proposal embodied in clause (3) of Question No. 46. While some contended that there may not be any statements made by the assessee which would implicate him in the commission of a criminal offence, others stressed the undesirability of the Income-tax Department taking upon itself the duty of keeping the moral conscience of the assessees. This criticism ignores the existing provision in sub-section (3) (a) of section 54 and proceeds on some misconception of the precise point we had in mind. We did not suggest that every statement which implicates an assessee in the commission of an offence should be brought to the notice of the proper authorities, but we intended that action should be taken only when such statements were made with a view to escape liability under the Income-tax Act. We take a simple example. An assessee makes a statement that a certain sum appearing in his accounts does not represent his profits, but represents a sum which he misappropriated from some other person. It may not always be possible for an Income-tax Officer to decide whether the statement was true or not; but if he accepts the statement as true and levies no tax on the sum on the ground that it was a misappropriated amount, it seems to us that there is a clear case for prosecuting such person. If, on the other hand, the Income-tax Officer does not accept the statement to be true and levies income-tax on the sum alleged to be misappropriated, the assessee is at least guilty of having attempted to mislead the Income-tax Officer. As the statement was made on oath, the Income-tax Officer may have to decide in each case whether the assessee should be prosecuted for having made a false statement or not. It seems to us that the further investigation about the falsity or otherwise of the statement should be left to the investigating authorities, and if a statement appears *prima facie* to implicate the assessee in the commission of a criminal offence, and if the statement was made in order to avoid or reduce liability to tax, the matter should be referred to the appropriate authorities, so that they may take suitable steps in the matter.

246. With regard to the proposal contained in clause (4) of Question No. 46, there was considerable opposition to it in the replies that we received. Some of the replies stressed the undesirability of fomenting private litigation by giving an opportunity to a third person to file a suit on the basis of the statement made by the assessee. Some of the replies pointed out that such a statement made by the assessee. Some of the replies pointed out that such a assessee does make a statement pleading the ownership of the property in a third person, he probably makes it after taking such third person into his confidence, so that the disclosure to such third person of the statement made

by the assessee would not have any practical results. Some others who did not seriously object to the proposal, however, pointed out that there was no necessity for enacting a provision of the kind suggested, as it was open to the Income-tax Officer to summon such third person under section 37 and to examine him to examine the correctness of the statement made by the assessee. We think that the proposal contained in clause (4) of the Question which has been accepted by the Legislature in enacting section 7(4) of the Income-tax (Investigation Commission) Act, should be adopted as a part of the ordinary law relating to income-tax. At present it is open to an assessee to assert the right of a third person to a certain property in order to escape the liability to tax on the income of such property in the knowledge that any statement made by him could not be used against him as being protected by the provisions of secrecy contained in section 54. It is true that, as pointed out in some of the replies, it is open to the Income-tax Officer to summon such third person and enquire whether the property alleged by the assessee to belong to such third person does in fact belong to him. But even so, it is not open to the Income-tax Officer to furnish to such third person a copy of the statement made by the assessee or even tell him that such statement has been made. Unless such third person is in possession of the statement made by the assessee, he cannot use it to support his title to the property, and the Income-tax Officer himself will be precluded from producing that statement under the existing provisions of section 54 of the Income-tax Act. If, however, there is such a provision in the law, as suggested in clause (4) of the Question, it would, in our opinion, act as a deterrent to any person falsely setting up a title in another person merely for the purpose of evading liability to tax on the income of such property. The Legislature has thought it fit to exempt from the operation of section 54 statements of this type so far as the Income-tax Investigation Commission is concerned, and, for the very reasons which appealed to the Legislature then, we think that it would, on the whole, make for a more efficient administration of the Act if such a provision was incorporated as a part of the Income-tax Act.

247. In Question No. 47, we enquired whether it would not be desirable to give wide publicity to cases in which the assessees are found to have made gross under-statements of their income, and to cases where persons have been convicted of income-tax offences of a serious nature. Here, again, a large majority of the replies were against the proposals made in the Question. Some of the replies, which were opposed to the proposal, stated that such a course would have no effect as a deterrent, especially in the present state of public apathy in which the immorality of tax dodgers does not seem to weigh too heavily on anybody's conscience. Others stressed the argument that such action would be regarded as vindictive by the public and evoke no sympathy from them. They stated that the Department is already very unpopular and the proposals of this kind would add to its unpopularity. Others objected to it on the ground that publicity of the kind contemplated was likely to affect the credit of the persons concerned. Some others stated that publicity was already given by the Press to the proceedings in Court when any one was convicted of an income-tax offence. There were, however, some Associations and persons (these were in a minority) who stated that publicity of the kind contemplated would serve as a deterrent. It has been suggested that if the returns themselves are published, businessmen might be afraid of their false statements being found out by their fellow businessmen who must know in a general way of the incomes or profits each of them has been making. This seems to be of doubtful expediency. This step will be of no use in the case of large incomes where differences cannot be easily detected. The position may be different where a man pretends he has made only losses in a particular year concealing his profits. In U.S.A. attempts were made by legislation to publish the names

of Federal income-tax payers in the hope that open announcements of taxable income, or of tax payments, would lead to discovery of evasion. The attempts had to be given up as there was a public outcry and no beneficial effect resulted (Schultz, American Public Finance, 3rd Edition, page 464). On the whole, we think that the proposal contained in clause (1) of the Question, namely, of giving wide publicity to persons who are found to have made gross under-statement of their income may be dropped. What is a gross under-statement must be a matter of opinion, and power of the kind contemplated may possibly be used—in some cases unjustifiably—to the detriment of the credit of the person concerned.

248. With regard to the publication of cases in which persons have been convicted of serious income-tax offences, we think that there is much to be said in favour of the proposal. Proceedings in criminal courts are public, and in gross cases they do attract public attention. The proposal, therefore, contained in clause (2) of the Question is not a novel one; and there is a certain advantage in public exposure of persons who are guilty of deliberately cheating the revenue. We would here quote from a reply that was received from a well-known Chamber of Commerce. They say: "The penalties and public exposure which should be applied to those who deliberately cheat should be of the utmost severity. One result of this would be that merit would attach to those who pay their just dues. As things are at present, there is no question but that those who are known to be the biggest deliberate taxation cheaters are received in all ranks of society in the country and by virtue of their very success in cheating are surrounded with an aura of ability and shrewdness, instead of being ostracised and stamped with obloquy. There can be no public conscience in the matter of taxation as long as these conditions obtain".

249. We would point out that this question was considered by the Indian Taxation Inquiry Committee (Todhunter Committee). They recognised that since 1922 the maintenance of secrecy in income-tax proceedings was "an important factor in the development of an efficient administration of the income-tax in India". But they were prepared to depart from the practice without infringing the principle of secrecy, by recommending that in the annual reports a list of persons penalised for income-tax offences may be published as is the practice in Australia. They thought this might operate as a deterrent to the commission of such offences (paragraph 250).

250. In U.S.A. also evasions discovered by a "flying squad" check are punished by maximum penalty and full publicity is given to their discovery and punishment. "Thus to be made an example before his neighbours may seem disproportionate punishment for the evader caught by this procedure where others escape examination and detection. But the tax evader has only his sharp practices to thank and the publicity given to his case is salutary warning to prospective evaders" (Schultz—American Public Finance—3rd Edition, page 329).

X.—Cancellation of Assessments, Revision and Review

251. Several of the replies received by us stressed the desirability of Income-tax Officers making a freer use of their powers under section 27 of the Act to cancel assessments already made where the conditions required under that section were satisfied. It is true that an application under section 27 to the Income-tax Officer to exercise his powers under that section and an appeal against the assessment itself are two concurrent remedies open to the assessee;

but this position is not peculiar to income-tax procedure. Even in Civil Courts two such concurrent remedies are available where a judgment debtor can make an application to the Court to set aside an *ex parte* decree and at same time can file an appeal in the higher Court against that decree. If the application for setting aside the *ex parte* decree succeeds, the appeal automatically falls through; if it does not succeed, the matter can be decided in appeal. Similarly, if the application under section 27 of the Act succeeds, the assessee need not pursue his appeal against the assessment before the Appellate Assistant Commissioner. We do not think, therefore, that there is any point in the submission made in some of the replies that these two concurrent remedies may lead to a conflict. Normally, an application under section 27 would be decided long before the appeal comes on for hearing before the Appellate Assistant Commissioner. We, therefore, recommend that a freer use be made, especially in cases decided under the proviso to section 13, or under section 23(4) of the power under section 27, particularly where the Income-tax Officer is satisfied that the true accounts of the assessee are forthcoming at that stage.

252. We should like to point out that the powers of revision under section 33A can be invoked only when an application is made for revision within one year of the date of assessment. We are aware of cases where the Department has recognised that the assessments made during the previous years were incorrect, has promised to give relief to the assessee in respect of future assessments only but has refused to revise earlier assessment, because the application for revision was made more than a year after the date of the order. The provisions of section 35 cannot be invoked in such cases because the mistake which resulted in the wrong assessment may not be apparent from the record; but where it has been established to the satisfaction of the Department that earlier assessments were made owing to a *bona fide* mistake of the Department or the assessee, we see no reason why an order in revision should not be permitted to be passed merely because more than a year has elapsed after the passing of the order which is recognised to be wrong. Section 35 allows a period of 4 years within which an order can be made for rectification of the assessment. Section 34 permits the Department to reopen a completed assessment within 4 or in some cases 8 years after the close of the relevant assessment year. We, therefore, recommend that under section 33A, it should at least be within the power of the Commissioner to relax the time limit for just and adequate cause. We would emphasise that it is wholly unjust for the Department to attempt to keep money which has been wrongly recovered owing to a *bona fide* error on the part of the assessee or the Department, and that such attempt to resort to technicalities must inevitably have reactions in the opposite direction as the assessees may also be tempted to play the same game.

253. A claim has been made that the assessee's right to ask for reopening of an assessment should be co extensive with that of Government under section 34 of the Act. This position is scarcely tenable because ordinarily the assessee will be in possession of all information material to the assessment. However, a measure of relief against genuine hardship even in this class of cases may be obtained by resorting to the revisional procedure prescribed under section 33A of the Act, as we have recommended above that the time limit prescribed by section 33A should be capable of being relaxed for just and sufficient cause. It is, however, conceivable that justice cannot be done in some cases even in exercise of the revisional powers under section 33A. We would accordingly suggest that a limited power of review may be conferred on the Income-tax authorities similar to that possessed by the Civil Courts on discovery of new material which could not have been produced with due diligence during the original proceedings. Reference in this connection may be made to section 24 of the English Finance Act of 1923 though that section is in terms limited

to assessments under Schedule D. Under that section any assessee, who alleges that the assessment was excessive by reason of some error or mistake in the return or statement made by him, may, at any time not later than 6 years after the end of the year of assessment, make an application for relief to the Commissioners of Inland Revenue, and the Commissioners are authorised to give by way of repayment such relief in respect of the error or mistake as is reasonable and just.

Y.—APPEALS

(Questions 48 and 49)

254. In question No. 48, we enquired whether it would not be necessary to provide a right of appeal.

(1) against an order under section 35 (Rectification) and

(2) against an order of an Appellate Assistant Commissioner refusing to extend the time for filing an appeal or dimissing an appeal as not filed within time.

The replies that we received were almost unanimously in favour of the view that there should be a right of appeal in both these cases. One or two replies pointed out that there is an appeal against both these orders even under the existing law, and that it has been so held by the Appellate Tribunal. But the matter is said to be pending before the High Court on an appeal against the order of the Appellate Tribunal, and we think that the matter should be placed beyond doubt by a suitable amendment of the law. It should be made clear that an appeal would lie against an order under section 35 both in cases where the authority takes action and makes an order of rectification or refuses to take action. The appeal against an order under section 35, we think, should be limited only to the rectification ordered or to the refusal to make an order of rectification. It should not be open to the appellant on such an appeal to re-open the merits of the original order except to the extent permitted by section 35.

255. It was pointed out by the Bengal Chamber of Commerce that there was no appeal provided against an order appointing a person as an agent of a non-resident, and they urged that this should be made the subject-matter of a separate appeal instead of leaving the question to be agitated in the assessment proceedings of the alleged principle. We think that there is a good deal to be said for this view, and recommend that the suggestion made by the Chamber of Commerce be accepted.

256. There was another point raised by the same Chamber and that related to orders passed under section 23-A of the Act. Under that section, it is open to an Income-tax Officer in certain cases of non-public companies to make an order, with the previous concurrence of the Inspecting Assistant Commissioner, that the undistributed portion of the previous year's assessable income of the company, as computed for income-tax purposes and reduced by the amount of Income-tax and super-tax payable by the company in respect thereof, should be deemed to have been distributed as dividend among the shareholders. Thereupon, the proportionate share of each shareholder can be included in the total income of such shareholder for the purpose of arriving his total income. Under the third proviso to sub-section (1) of section 30, a shareholder in a company in respect of which an order under section 23-A has been passed by the Income-tax Officer cannot in respect of the matters determined by such order appeal against the assessment of his own total income. The only remedy, therefore, for the company or the shareholders aggrieved by the order under section 23-A is to appeal against the order itself. There is no doubt that the company can appeal against such an order. In such a case, the Chamber has desired that it should be made clear that there is no necessity for the individual shareholder to appeal. It appears

to us that this position is implicit in the law, as it stands, and if the company succeeds, the results flowing from a successful appeal would be applicable in respect of all the shareholders. But a somewhat difficult position is likely to arise if the company does not wish to appeal and only some of the shareholders wish to do so. Such a situation may arise if there is a large number of small shareholders and only a few big ones. The section was designed to prevent non-public companies from postponing declaration of dividends lest such dividends may lead to the imposition of super-tax on the individual incomes of the shareholders. If the dividend is deemed to be declared under the provisions of section 23-A, shareholders of limited means would stand to benefit by such an order inasmuch as they will be entitled to a refund in respect of such dividend of the difference between the income-tax deducted at the maximum rate and the tax due from them at the rate applicable to their own individual incomes. In such cases, it may be to the interest of such shareholders to acquiesce in the order under section 23-A, while it would be to the interest of shareholders of substantial means to appeal against that order lest the dividend deemed to have been declared should be added to their individual incomes with the consequent super-tax liability. If the small shareholders are in a majority, the company may decide not to appeal to the detriment of the interest of the few shareholders of substantial means. We think that in principle the right of appeal should be conceded to any shareholder even though the company does not choose to appeal; but, in our view, such cases are likely to be very few because in most of the private limited companies the shares are held by a few persons of substantial means and in most cases where an order is passed under section 23-A. There would be an appeal by the company at the instance of shareholders, who are persons with big incomes and have a controlling interest in such companies.

257. It was further pointed out in one or two replies that there should be a provision for an appeal against the recovery of tax under section 23-A (3) (ii). Under that sub-section, where the proportionate share of a member of a company in the undistributed profits of the company has been included in his total income under the provisions of sub-section (1) of that section, the tax payable in respect thereof is recoverable from the company, if it cannot be recovered from such member. It is difficult to see on what basis such an appeal could be founded. The Income-tax Officer proceeds to recover the tax from the company itself if it cannot be recovered from such member. Such a procedure is possible if the original order under section 23-A (1) remains unassailed. So long as the order stands, it would be too much to ask the Department to exhaust every possible remedy against the shareholder before seeking to recover the tax from the company. The very basis of the order under section 23-A is that the undistributed amount is still with the company, although it is conceivable that in fact the company may not be in possession of sufficient assets. It will be difficult to define the extent to which the Department should make an attempt to recover the amount from the shareholder before it can take steps against the company. But as we have pointed out in the preceding paragraph, the main body of shareholders in a non-public company are persons of substantial means and the cases of non-recovery of tax and the consequent resort to section 23-A (3) (ii) would be extremely few. However, in theory, the right of the company to appeal against the decision of the Income-tax Officer to recover the tax from the company, instead of from the shareholder concerned, may be conceded, although it would be availed of in a very limited class of cases.

258. In question No. 49, we enquired whether a non-resident assessee, who fails to pay the demand, should not be put on condition that he should deposit

the tax before any appeal filed by him against the assessment is heard; alternatively, whether he should not be asked to give security for payment in the event of decision going against him. With the exception of four or five Associations, most of the replies were in favour of the proposal, and stated that either of the two alternatives may be adopted. Those who were not in favour of the suggestion pointed out that the proposal would have no practical use. They pointed out that there was nothing to prevent the Department from recovering the tax in spite of the fact that an appeal was filed. They contended that if the non-resident had no assets in the Indian Union or had failed to pay the demand, he was not likely to make the required deposit or furnish the required security before the appeal is heard, and, in any case, it would make no difference to him whether his appeal is heard or not. One Association went to the length of suggesting that not only should there be no demand for deposit or security as contemplated in the question, but even the recovery of the tax should be stayed unless the Appellate Assistant Commissioner before whom the appeal was pending permitted the recovery on the ground that the appeal was *prima facie* frivolous.

259. In our opinion, the view expressed in the very large majority of the replies from persons and Associations whom we consulted should be accepted. It is true that there is nothing to prevent the tax being recovered even during the pendency of an appeal, but the case that we contemplate is where the Department has failed to recover the tax from the non-resident, and the question that we put to the public was whether in such cases deposit or security should not be demanded before the appeal was heard. Those who argued that the proposal was of no practical value, because a non-resident who had failed to pay the tax would not care to make the deposit or give the security ignored the consideration that the non-resident had, in fact, chosen to file an appeal. If the non-resident is not keen about the appeal, the demand for security or a deposit will make no difference to him. On the other hand, if he has no stake in the appeal itself, then it would not be inequitable to call upon him to make the necessary deposit or furnish the necessary security. It is quite likely that the insistence on security may bring to the notice of the authorities concerned some concealed assets which would not otherwise have been known to the Department. It is equally possible that even though the tax was not recoverable at the beginning, the circumstances of the assessee may have so changed by the time the appeal comes on for hearing as to make the demand for a deposit or security not unavailing. In any case, precaution of the type suggested would certainly act as a check on frivolous appeals. We would, therefore, suggest that before the appeal of a non-resident who had failed to pay the demand is heard, he should either deposit half the amount of the tax payable or give security for the full amount. We suggest that a request in this behalf should be made before the appellate authority by an Income-tax Officer after he has obtained the previous approval of the Inspecting Assistant Commissioner. It is conceivable that in some cases the order under appeal may *prima facie* be so unsustainable that it would be an unjustifiable hardship upon the non-resident to ask him to furnish the deposit or give the security. In order to meet such cases, we would add a provision that the requirement of the deposit or the security may be waived if the appellate authority so orders. We may point out in this connection that the proposal made is not novel. Under section 213 of the Australian Act, where the Commissioner has reason to believe that any person intends to carry on business in Australia for a limited period only, or in cases where the Commissioner for any other reason thinks it proper so to do, the Commissioner may require such person to give security by bond or deposit or otherwise to the satisfaction of the Commissioner for the due return of, and the payment of, income-tax on the income derived by that person. The deposit for the payment of income-tax is demanded even before the business is started. The proposal we are making is modest in comparison.

In the proposal under consideration, we are recommending that the deposit of one half of the tax due, or furnishing of security for the whole amount, may be insisted on in the case of a non-resident, only where he has failed to pay the tax after assessment and still desires to prosecute his appeal against the assessment.

260. It has been suggested that the provision with regard to the deposit or security should not be made applicable to an appeal by an agent who has been assessed in pursuance of an order under sections 42 and 43. We do not consider that any real hardship can arise even in such cases. Under the second proviso to section 42 (1), such an agent is entitltd to retain out of any money payable by him to such non-resident person a sum equal to his estimated liability. It should, therefore, be possible for the agent to pay the tax or to make the necessary deposit.

Z.—STAY OF RECOVERY PROCEEDINGS

261. The Income-tax Act makes no provision for stay of recovery proceedings pending the decision of any appeal filed by an assessee under the Act. If any tax, penalty or interest is due in consequence of any order passed under or in pursuance of the Act, the Income-tax Officer has, under section 29, to serve upon the person liable a notice of demand. Under section 45 of the Act, any amount specified as payable under a notice of demand under sub-section (3) of section 23-A, or under section 29, or on an order under section 31 or section 33, has to be paid within the time specified in the order or as laid down in that section. There is no provision for stay of recovery proceedings except to this extent, *viz.*, where an appeal is filed under section 30, the Income-tax Officer may, in his discretion, treat the assessee as not being in default as long as such appeal is undisposed of (see section 45). Even this limited provision does not apply where an appeal under section 33 is pending before the Appellate Tribunal, nor when an application for revision is made to the Commissioner under section 33-A, nor when a reference to the High Court is pending under section 66 of the Act. On the contrary, sub-section (7) of section 66 lays down that notwithstanding that a reference has been made under section 66, the income-tax shall be payable in accordance with the assessment made in the case. We can well imagine cases where for want of a provision regarding stay, considerable hardship may be caused to an assessee. If the appeal is successful and a part or whole of the tax recovered has to be refunded, the assessee gets no interest on the amount of refund though he may have, in the meanwhile, borrowed money to pay the tax. We consider that specific provision should be made in the Act enabling the Appellant Assistant Commissioner, the Appellate Tribunal, the Commissioner or the High Court to stay the recovery of the tax, penalty or interest pending the disposal of the appeal, application or reference, as the case may be. We realise that care must be taken to see that the machinery for appeals, application or revision is not utilised merely for the purpose of gaining time. We, therefore, recommend that the Appellant Assistant Commissioner, the Appellate Tribunal, Commissioner and the High Court should be empowered to order stay of the recovery to the extent to which the tax, penalty or interest is in issue before them if, on a perusal of the order which is the subject-matter of appeal, application or reference, they have reason to think that the order is contrary to law or otherwise erroneous and unjust. Applications for stay should be required to be filed without unreasonable delay and on such application, notice should be issued to the Income-tax Officer concerned. On hearing the Income-tax Officer, the Appellate Assistant Commissioner, the Appellate Tribunal, the Commissioner or the High Court, as the case may be, may call upon the assessee to give security for so much of the amount as is covered by

the stay order. If ultimately the assessee fails either wholly or partially, he should be required to pay interest at 3 per cent on the amount originally stayed but subsequently ordered to be recovered pursuant to the decision in the appeal, application or reference.

AA.—APPELLATE PROCEDURE

[Questions 50 and 32 (Second half)]

262. In the course of our discussions with Income-tax Officers at various centres, we found a persistent complaint made that the assessees are unwilling to place all their cards before the Income-tax Officer, or to produce all the evidence which is in their possession, so as to enable him to arrive at a correct estimate of their incomes. It was stated that the assessee takes the chance that the estimate made by the Income-tax Officer may be below the real income of the assessee; but in the event of its turning out that the estimate made by the Income-tax Officer is excessive, the assessee produces the evidence in his possession before the appellate authority, and thus gets the assessment reduced. Consequently, it was suggested (and we embodied the suggestion in the first part of Question No. 50) whether it would not be right to enact in the statute itself that fresh evidence should be admitted in appeal only in cases in which the same could not have been produced before the Income-tax Officer even with due diligence and attention. We also enquired in the second part of that question whether in all appeals against the assessments under the Act the onus should not be specifically laid upon the appellant to show that the Income-tax Officer's assessment order was wrong. We mentioned that this was the rule in England.

263. The replies that we received on the first part of the question were preponderatingly in favour of the view that the discretion of the appellate authorities should in no way be fettered by a specific provision in the statute itself that no evidence should be admitted in appeal unless it could not have been produced before the Income-tax Officer even with due diligence and attention. Our attention was pointedly invited to the fact that the assessees were in a large majority of cases comparatively ignorant of the provisions of the Income-tax Act, and were not always assisted by Legal or Accountancy Advisers. Other replies stressed the point that until the assessment order was in his hands, the assessee does not know on which points his contention has been rejected, and he has no idea till then as to the points on which the Income-tax Officer desired evidence to be adduced. One of the replies went the length of saying that unless fresh evidence was allowed to be admitted before the Appellant Assistant Commissioner, the Appellant Assistant Commissioner would merely be an automation for rejecting all appeals. On the other hand, some others, especially those who were concerned with the administration of the Act, suggested that no statutory provision need be made as the present practice leaves sufficient discretion with the appellate authorities to admit fresh evidence, when it is necessary to do so, in the interest of justice, having regard to the conduct of the assessee when the proceedings were pending before the Income-tax Officer.

264. Rule 29 of the rules framed by the Income-tax Appellate Tribunal makes it clear that the parties to the appeal shall not be entitled to produce additional evidence, either oral or documentary, before the Tribunal; but if the Tribunal requires any documents to be produced, or any witness to be examined, or any affidavit to be filed, to enable it to pass orders, or for any other substantial cause, or if the Income-tax Officer has decided the case

without giving sufficient opportunity to the assessee to adduce evidence, either on points specified by him, or not specified by him, the Tribunal may allow such documents to be produced, or any witness to be examined, or affidavit to be filed, or may allow such evidence to be adduced. No complaint has been made to us with regard to the working of this rule framed by the Appellate Tribunal. The complaint relates mostly to the adducing of fresh evidence before the Appellate Assistant Commissioner.

265. We think that there is a good deal to be said for the objection that the assessee may not know on what points the Income-tax Officer desired evidence to be produced, until he sees the final order of assessment passed by the Income-tax Officer. There is no provision in the Act such as we find in the Code of Civil Procedure about the points in dispute being reduced to the form of issues to which the parties know that, the evidence is required to be directed. We have had it stated on high authority that even though evidence was produced before the Income-tax Officer, there is no mention of it made either in the order of the Income-tax Officer or in the order sheet maintained by him. The same authority has stated that even the contentions of the parties are not very often sufficiently brought out in the order made by the Income-tax Officer. Under the circumstances, it appears to us to be unfair to forbid production of evidence at the appeal stage, where the assessee had no opportunity to produce the necessary evidence, or was not sufficiently informed of the points on which evidence was required to be produced. We understand that the Appellate Tribunal made a reference to the Central Board of Revenue, requesting that instructions be issued to the Income-tax Officers that the statements of the assessees, or their authorised representatives, should be reduced to writing, and that the Tribunal was informed that instructions had been issued in the past, and that the Income-tax Officers were being reminded of those instructions. Inspite of this, it is the experience of the President of the Appellate Tribunal that the orders made by the Income-tax Officers do not pay sufficient attention to this aspect of the matter. It must, however, be remembered that if evidence is admitted freely on appeal, it will merely encourage assessees to keep back books from the Income-tax Officer and take the chance of under-assessment whereas confirmation of the Income-tax Officer's order—unless grossly unreasonable—will indirectly compel the production of accounts and other evidence before the Income-tax Officer. We think that the ends of justice will be served by a rule to the effect that the Appellate Assistant Commissioner should not allow fresh evidence to be brought on record in cases where the relevant material was wilfully withheld by the assessee before the Income-tax Officer. In deciding whether in any particular case the evidence has been so wilfully withheld, the Appellate Assistant Commissioner will no doubt give due weight to the consideration whether the assessee was given a fair chance to produce the evidence, whether he was in a position to know on what points evidence was required to be led, and whether with due diligence and attention such evidence could have been produced before the Income-tax Officer. In order to enable the Appellate Assistant Commissioner or the Appellate Tribunal to decide whether the evidence was wilfully witheld, the order sheet should show what opportunity was given to the assessee to adduce evidence an don what points evidence was required to be produced. Notice under section 22 (4) should indicate with some degree of precision what documents and accounts were required to be produced. It would, perhaps, be better if this point was made clear by a specific provision, not necessarily in the statute itself, but by a statutory rule, as has been done by the Income-tax Appellate Tribunal in rule 29 of their rules.

266. On the second point referred to in Question No. 50, the general opinion was that the onus of proving that the Income-tax Officer's assessment was wrong was, even under the present practice, laid upon the appellant. Some of the replies stated that it was not the rule in England that the onus was specifically laid upon the appellant. Others made the suggestion that, although in a large majority of cases the onus may be laid upon the appellant, still in some cases, especially those in which assessments were made under the proviso to section 13, the Income-tax Officer ought to justify how the assessment made was correct.

267. As regards the position in England, it has been stated at page 382 of the Tenth Edition of Konstam's Law of Income-tax that it is for the appellant to show that the assessment appealed against is excessive. This was pointed out by Lord Hanworth in *Haythornthwaite* vs *Kelly* (11 T. C. 657) where he observed that the onus of proving the assessment excessive rests heavily on the shoulders of the tax-payer and not upon the revenue. The reason for this was explained by Atkinson J. in *Dixon and Gaunt Ltd., and James Hare Ltd. vs. Commissioners of Inland Revenue* (26 A.T.C.106) where he said that otherwise the tax-payer "would only have to keep no books, no banking account, insist upon being paid in Treasury notes and no one living could ever prove what his income was or establish any liability to income-tax". In certain specified cases, however, *e.g.*, in an appeal against a direction, the burden shifts to the revenue as was pointed out by Atkinson J. himself in the case referred to above and by the House of Lords in the case of *Thomas Fattorini and Sons Ltd., vs. the Commissioners of Inland Revenue* (24 T.C.328) which was a case falling under section 21 of the Finance Act of 1922 corresponding to section 23-A of our Income-tax Act, 1922. The general rule, however, is that the burden of proving that the assessment order is wrong is upon the appellant. That practice has been adopted in varying degrees even in India. But there is some distinction between the position as it obtains in England and the position in India, and this point has been stressed in some of the replies which we received. It has been argued that the Income-tax Officer is not in a position similar to that of the general Commissioners in England. He is not an independent officer taking a judicial decision between two conflicting points of view. In India he is both an investigating officer as well as an assessing officer making a semi-judicial order. Therefore, the principles which obtain in England, or which are followed in the hearing of appeals against the orders of Civil Judicial Officers, cannot be invoked with the same degree of emphasis in dealing with appeals against the orders of Income-tax Officers.

268. The difficulty arises particularly in dealing with appeals against assessments made under the proviso to section 13. Having rejected the accounts produced by the assessee, the Income-tax Officer has to make assessments on such basis and in such manner as he thinks fit. The law does not provide that the account books should be maintained in any particular manner, and, before making an assessment under the proviso, a case has to be made out as to why the Income-tax Officer has resorted to it. Even when a sufficient case has been made out for rejecting the accounts, the Income-tax Officer in making an assessment under the proviso proceeds to make an estimate "on such basis and in such manner as he thinks fit". We have suggested elsewhere (see paragraph 215) that the Income-tax Officer should give an opportunity to the assessee to adduce any evidence, if he wishes to do so, after the officer has decided to proceed under the proviso to section 13 of the Act. But at the appeal stage, it may not always be possible for an assessee to controvert the various points on which the Income-tax Officer has

relied in making the estimate. The usual procedure in making the estimate is to compute the percentage of profits made by similar businesses in similar localities. The assessee has no means of knowing the percentage of porfits on the basis of which assessments have been made in other cases. Occasionally he comes to know that the profits of some other assessee have been computed at a lower figure, and then he brings this fact to the notice of the Appellate Assistant Commissioner or the Appellate Tribunal. On he other hand, in order to support an estimate made by the Income-tax Officer, the Departmental Representative has to bring to the notice of the Appellate Tribunal assessments made in other cases of similar nature. The whole position, therefore, resolves itself to this: What should be the approach of the appellate authorities in such appeals. The point of view of the appellate authorities is that they have to see whether the estimates made by the Income-tax Officer, or by the Appellate Assistant Commissioner, are reasonable. On the other hand, it has been contended on behalf of the Department that the approach on such a footing is wholly wrong. The Department argues "that in income-tax proceedings there is only one party in possession of the facts and that is the assessee. He alone knows what his income is and it should be for him to prove it. And, therefore, it is not a question whether the estimate of the Income-tax Officer or the Appellate Assistant Commissioner is reasonable, but a question whether the assessee has proved that the assessment is excessive, and by how much. This he should do from his own records and not by quoting estimates made in other cases". In our view, it should be for the appellant to prove, in the first instance, that the order made by the lower authorities is incorrect; but if the order is in the very nature of the case based upon findings which it would not be possible for an appellant to controvert out of his own knowledge, then it should be for the Income-tax Officer or the Departmental Representative to satisfy the appellate authorities that the order appealed against is reasonable. We cannot accept the view that the appellate authorities must in all cases confirm the order appealed against if the appellant is not able to satisfy them that it is wrong. The appellate authority itself must be satisfied that the order of the Income-tax Officer or the Appellate Assistant Commissioner is not unreasonable, and even where the appellant fails to adduce sufficient reasons against that order, the appellate authority cannot divest itself of its responsibility to see that the assessment is not unfair. In referring to the question of the onus, we were not thinking so much of the abstract doctrine of onus, *viz.*, that the burden should lie on the party which would fail if no evidence was produced, as of the principle that an order of the Income-tax Officer should *prima facie* be presumed to be right and that in this sense the burden should be on the appellant. As we have stated before, this presumption is, to some extent, weaker than in the case of regular judicial pronouncements, where the appellant has to prove that the odrer of the lower Court is wrong. Greater latitude may, therefore, be allowed in the matter of onus in income-tax proceedings. The lesser the evidence in the case, the greater is the reason why it would be hazardous for an appellate authority to substitute its own conjectures in place of the estimate made by the Income-tax Officer, as the latter may be expected to be more in touch with the particular class of cases, the locality where the business is situated, the profits generally made in that particular business, etc. The appellate authority must, no doubt, be alive to its responsibility to see that the estimate made is not unreasonable; and, where it feels that the Income-tax Officer's decision is unreasonable, or, as the Courts say, no reasonable man could have arrived at that decision, the burden would naturally shift to the Income-tax Officer to satisfy the appellate authority that his estimate is reasonable. We think that a convention might be developed that the order of the Income-tax Officer or Appellate Assistant Commissioner

should not normally be superseded, unless the appellate authority felt that the order of the Income-tax Officer or Appellate Assistant Commissioner was unreasonable and there was sufficient ground to come to a different conclusion not merely because it would itself have come to a different decision if it were the first authority deciding the case.

269. What we have said above covers in a large measure the point raised in the second part of Question No. 32 in which we enquired what the scope of the inquiry should be in an appeal against a best judgment assessment. Prior to the amendment of 1939, there was no appeal provided by law against a best judgment assessment under section 23 (4). There was considerable agitation against this omission in the Indian law, because in England all assessments were subject to appeal. The point was considered by the Ayers' Committee and they observed as follows in Chapter XV of their Report:—

> "Assessments are made under this sub-section if an assessee fails without reasonable cause to comply with a notice issued by the Income-tax Officer calling for evidence or for a return of income. It is no doubt true that this result is very often due to deliberate neglect by the assessee of his statutory duty, but the argument used by some Income-tax Officers that any over-assessment includes a penalty for such neglect is obviously bad, since the section requires the Income-tax Officer to estimate the profits according to the best of his judgment. There is no authority deliberately to over-assess in these cases, and accidental over-assessment in some cases cannot be an equitable measure of the penalty properly exigible. An argument in favour of the retention of non-appealability of these assessments is that given the right of appeal assessees would withhold information from the Income-tax Officer. appeal if his estimate of profits were excessive. but take no action if his estimate were below the true profits. This was, we understand, the principal reason for the change in the law in 1918, making those assessments non-appealable. The inference of under-assessment, however, may frequently be drawn if no appeals are lodged against a succession of estimated assessments, and whatever may be the force of argument for non-appealability under the present law, we consider that it would lose its validity if provision is made for the imposition of penalties of failure to comply with notices and for the extension of the time-limit within which additional assessments could be made."

It is in pursuance of these recommendations that an appeal has now been provided and separate provision has been made for the imposition of penalties under section 28. We are, therefore, unable to agree with the suggestions made to us by a few that assessments under section 23, sub-section (4), should again be made non-appealable.

270. An appeal in such case may cover two points. Firstly, whether the conditions requisite for the proper exercise of the power under section 23(4), or the discretion under the proviso to section 13, existed in a particular case, and, secondly, if the conditions requisite were present, whether the estimate of profits made by the Income-tax Officer should be modified in appeal. There can be no doubt that the scope of an appeal against a best judgment assessment must include the consideration of the question as to whether the Income-tax Officer was right in proceeding under section 23(4) or under the proviso to section 13. But on the second question there has been some divergence of

opinion. One point of view is that the Income-tax Officer being in a better position to assess profits on an estimated basis, the estimate made by him should not lightly be altered, even though the appellate authority felt that it would have come to a different conclusion if it had itself to make the estimate. The second view is that the appellate authority must come to its own decision as to what the proper estimate of profits is, even if that estimate differs from that of the Income-tax Officer. Those in favour of the first view rely on the practice adopted by the appellate Courts in hearing an appeal against the verdict of a jury. The appellate Court does not interfere with the verdict of the jury even if, as a trial Court, it might have come to a different conclusion, unless the verdict of the jury is perverse. It is also argued that if the appellate authority interfered with the estimate made by the Income-tax Officer, there will be no inducement for an assessee to place all his cards before the Income-tax Officer. He may withhold all the evidence when the matter is before the Income-tax Officer, take his chance that the estimated assessment will be lower than what is should be, and if the assessment happens to be higher, then place all the materials before the appellate authority. We consider that the proper course to be adopted is one which steers clear of both the extremes. As we have stated in paragraph 265 if the assessee had an opportunity and was in a position to produce relevant evidence but had wilfully withheld it from the Income-tax Officer, he should not, in our opinion, be allowed to lead such evidence for the first time before the appellate authority. If even with these precautions fresh material is admitted, the appellate authority should give due weight to it and the estimate made by the Income-tax Officer may be set aside if it is found to depart materially from the estimate mad by the appellate authority after such consideration.

271. A complaint was made to us (and we found that there was some justification for it after some of the appellate orders were perused by us) that appellate authorities sometimes accept practically all the arguments advanced by the Income-tax Officer in making a best judgment assessment, but make a variation in the percentage of profits estimated by the Income tax Officer "in all the circumstances of the case". This method of dealing with orders of the subordinate authorities has little to commend it and is calculated to add to the difficulties of the assessing officers while encouraging assessees to gamble on the chance of a reduction by the appellate authorities. If, on the other hand, assessments are not reduced in appeal in the above manner, the assessee will not take the risk again of suppressing his accounts in the next year. It is true that the appellate authorities sometimes discover that the same Income-tax Officer has accepted a lower rate of profits in one case and a higher rate of profits in another, although both the businesses were conducted in the same locality and almost under the same circumstances. This kind of assessment has, of course, to be avoided, and gross instances of this kind should be brought to the notice of the Inspecting Assistant Commissioners by the appellate authority concerned. But save in such circumstances, the appellate authority should not interfere with the estimates made by the subordinate authorities if they are not wide of the mark. Ordinarily, the Income-tax Officer is in a better position to make an estimate as he is an officer on the spot and has more knowledge of local conditions. It is difficult to say in such cases that the estimate of the appellate authority is likely to be more accurate than that of the Income-tax Officer.

BB.—REFUNDS

(Questions 51 and 55)

272. In the course of our enquiries, we heard persistent complaints about the enormous delays that occur in dealing with claims for refunds. We, therefore, invited suggestions (Question No. 55) as to the remedies which may usefully

be adopted to redress this grievance. We also took the opportunity thus presented to enquire whether section 48 of the Act which deals with refunds receives unduly narrow interpretation at the hands of the Department, and, if so, how this could be set right by an amendment of the Act.

273. Most of the replies we received stated that the existence of the delays was due to the fact that the Income-tax Officers though that the making of a refund was an unimportant part of their duties, their main work being the making of assessments and the collection of revenue. Some replies went so far as to say that this kind of feeling was fostered by the superior officers taking no notice whatever of the delays in making refunds. Most of the replies suggested that the staff dealing with refunds should be augmented, and that in some cases independent "Refund Circles" should be started. They insisted on a close watch being kept on the progress of the disposal of refund applications. Many were in favour of the view that if applications were not disposed of within a reasonable time, Government should be required to pay interest at 6 per cent. on the amount of refund after the expiry of that period. As regards the interpretation of section 48, there were some complaints, and these related only to the meaning ascribed to the words "final and conclusive" in sub-section (4) of section 48 of the Act.

274. We may observe that this grievance of delays in dealing with refund applications is neither new nor peculiar to India. The Report of the Departmental Committee on Income-tax drew attention to such delays in the United Kingdom as far back as 1905 (see paragraph 114 of their Report). The Royal Commission on Income-tax (1920) also stated in paragraph 613 of their Report that their attention had been directed by several witnesses to the objectionable effect of the system of taxation at source under which assessees experienced a good deal of delay in obtaining repayment of money which properly belonged to them. In India, the Ayers' Committee referred to a number of representations they had received concerning the delay in dealing with refund claims. They thought that although in some measure the delay was due to the necessity of awaiting advice from Circles dealing with companies as to the percentage of profits which has borne tax each year, the general attitude of the officers of the Department regarding refund claims left much to be desired. They found that many Income-tax Officers regarded refunds as the last thing which needed attention, in spite of the instructions contained in the Income-tax Manual enjoying a more sympathetic treatment in the matter of refunds. They recommended that Inspecting Officers should make it a part of their duty to call for periodical reports of progress, and to see that the general progress made throughout the year was satisfactory and that no case was delayed without adequate reason.

275. The main reason why claims for refund arise is the system of deduction at source or taxation at source when the deduction or taxation is made at the maximum rate. The hardship resulting from this deduction to persons who are exempt or entitled to considerable relief is clearly a serious one especially where dividends or interest on securities are their main source of income, unless adequate and prompt measures are taken to deal with all claims for refund. Where the adjustment in favour of the assessee can be made by a deduction from a direct assessment upon him in respect of some other source of income, the Income-tax Officer quite properly adjusts matters in this way: but there are many cases where this is not possible and where the only remedy the tax-payer has is to lodge a claim for refund.

276. In cases falling under section 48(1), an application has to be made as prescribed by Rules 36 to 40. But where a refund becomes due as a result of the order of the Appellate Assistant Commissioner or the Appellate Tribunal, the appellate authority has to make a direction for the refund of the excess

amount or the amount wrongly paid [see section 48(2) of the Act]. Section 33 provides for the Commissioner making in revision "such orders as he deems fit", which presumably include an order for the refund of any excess tax already paid, should the order in revision entail the payment of such amount. Sub-section (3) of section 35 makes specific provision directing payment of refund which may be due if the rectification contemplated by that section has the effect of reducing the assessment. Similarly, under sub-section (7) of section 66 if the amount of assessment is reduced as a result of the reference to the High Court, the amount of excess tax paid has to be refunded. In all these cases no separate application is necessary for payment of refund; but the complaints made to us have reference to all kinds of refunds due to an assessee, whether an application for such refunds is required by law or not.

277. There are some obvious difficulties which make it well nigh impossible to dispose of all refund applications quickly. For example, an application for the refund of tax deducted at source in the case of interest on Securities, or deemed to have been paid on behalf of the assessee under section 18, cannot be disposed of until the assessment itself is complete and the real tax liability of the individual concerned ascertained. This consideration militates against the suggestion made in some of the replies that the refunding officers should be different from the assessing officers. The assessment of the individual himself may depend on the completion of other assessments, such as that of a registered firm or even of unregistered firm and the eligibility for refund cannot be determined until those assessments are complete. The reasons given in the 1936 Report of the Ayers' Committee for delay in making refunds, *viz.*, delay in assessment of companies, to ascertain what percentage of the profits included in the dividend to the shareholders has borne the tax, no longer hold good to anything like the same extent. Under Rule 14 of the Rules under the Act, a company paying the dividend has to certify that the income-tax on the entirety/such part as is liable to be charged to income-tax, of the profits and gains of the company of which the dividend forms a part has been or will be duly paid by the company to the Government of India. At the time when the 1936 Committee made their report, companies holding tax-free securities could not say what percentage of the profits was in the form of interest on tax-free securities until the assessment was complete. At present there are no tax-free securities to speak of. It is possible to give without delay the information with a fair degree of accuracy, and a large number of companies do in fact give that information. With this information before them, it should be possible for Income-tax Officers to deal expeditiously with applications for refunds from holders of a few shares (who form the bulk of the applicants or refunds). Such persons have either no taxable income or their total income suffers tax at a much lower rate than the maximum at which the tax has been deducted or paid at source. We realise that some difficulty may arise in the case of companies part of whose income is agricultural, but in the case of tea companies at least it has been laid down that 60 per cent. of the income is to be regarded as agricultural.

278. We think, therefore, that it should be possible to expedite the work of refund with some planning and proper supervision. Where the staff is inadequate, it should be brought to the proper strength required for quick disposal. All applications for refund should not be huddled up together and filed in chronological sequence to be taken up only when an occasion arises to deal with them. Attempt should be made to separate those which can be disposed of quickly from those which have necessarily to wait. As soon as a refund application with the necessary vouchers is received, it should be checked to see whether the vouchers relate to the same year, whether the ownership certificates have been properly signed, etc. If any defect is noticed, it should be asked to be set right immediately. We understand that such defects are discovered only when the applications are taken up for disposal and further

time spent in correspondence to get them set right. Applications which are found to be *prima facie* valid and supported by proper vouchers, should be divided into two batches—

(1) Those which could be disposed of easily, *e.g.*, where exemption certificate requires slight alteration owing to a change in the nature of holding, those in which the vouchers are few in number, those in which refund arises in connection with tax deducted at source, etc.;

(2) Those which require some examination, *e.g.*, where persons asking for refund have small income from other sources or where the number of vouchers is large, etc.

There is no reason why applications falling under class (1) should not be disposed of within a week or two. In this connection we would invite attention to paragraph 125 of the report of the Departmental Committee on Income-tax in the United Kingdom of 1905. They say: "The number of stages through which each claim passes should be minimised as far as possible. and the claims should be classified on receipt so that the simpler cases could be dealt with by less experienced members of the staff and be disposed of promptly, while the more complicated cases undergo more careful scrutiny. Further, we think that, without any serious risk to the revenue, claims, though not complete as regards vouchers, etc., might be allowed provisionally and the amount paid, essencially during the months of March to June inclusive, the examination of the claims being left to be taken up and completed as soon as practicable after the period of pressure is over. A printed notice should be sent with the moneyorder issued in payment of the claim, explaining that early repayment is made provisionally in the interest of the claimants themselves and must be subject to any readjustment that may be found necessary on a full examination of the claims. Such a provisional acceptance of the claim and repayment might certainly be made in the case of those who claim year after year and whose claim it cannot be necessary to subject to such minute investigation as may be necessary on the first occasion". The Central Board of Revenue might well consider it some system on these lines might not be adopted with profit in this country also in dealing with applications for refunds.

279. It should be impressed on Income-tax Officers that the disposal of refund applications is as important a part of their duty as that of making assessments and any dereliction of this duty on their part would be taken serious notice of. A careful watch should be kept over the disposal of such refund applications. We understand that even now some returns are called for as regards such applications, especially with regard to those which have been pending for more than 3 months. But as Inspecting Assistant Commissioners also do not seem to attach much importance to this part of the work of Income-tax Officers, the arrears go on mounting much to the inconvenience of small assessees or persons having non-taxable income. We are, therefore, in favour of the suggestions that after the expiry of six months from the date of the receipt of the refund application after the expiry of six months from the applicants should be entitled to interest at 2 per cent. on the sum found due to them unless the applicant himself is mainly responsible for delay in the disposal of the application. We consider that a period of six months should normally be sufficient for the disposal of the generality of refund application. It may be argued that in some cases the delay may be the result of pendency of other matters, for example, assessment of firms, etc., and that therefore Government should not be held responsible for the delay in making refunds. Even assuming that there is some justification for argument on these lines, there still remains the fact that the Government has had the use of the additional amounts all the time, and there is no reason why, at least on that account, Government should not pay interest at a small rate on the amounts which subsequent investigation shows were really not due

from the assessees. If this line of reasoning were carried to its logical conclusion, it would follow that the interest should be payable from the date on which the excess amount was deducted at source. But we do not intend to go so far, and have, therefore, recommend that interest should begin to run after the expiry of six months from the date of the receipt of the application for refund. This liability to pay interest may also act as a wholesome check on the apathy at present displayed by the officers of the Department in disposing of refund applications.

280. In respect of refunds arising as a result of orders of appellate authorities under section 48(2), or of orders in revision made by Commissioners under section 33A, or of orders in rectification made under section 35, there is practically no justification for any relay in making the refunds. In these cases, we suggest that the liability to pay interest should arise 3 months after the expiry of the order which necessitates refund. There is nothing novel in this suggestion that interest should be payable on the amounts of refunds due to assessees or other claimants. Under sub-section (7) of section 66, where, as a result of the order of the High Court on a reference, the assessment is reduced and the amount overpaid has to be refunded, the refund has to be made with such interest as the Commissioner may allow.

281. With regard to the second part of the question, the complaints made in some of the replies related to the narrow interpretation which was placed on the words "final and conclusive" in sub-section (4) of section 48. An example of how this section and section 33A (corresponding to former section 33) are applied, is to be found in the Tribune Trust case—1944 I.T.R. 370. In that case the Tribune Trust of Lahore was held by the authorities in India not to be a Trust wholly for charitable purposes, and was, therefore, taxed on its income for the year 1932-33. When the matter was taken up to the Privy Council, their Lordships held in 1939 (7 I.T.R. 415) that the income derived by the Trust was exempt from tax under section 4(3)(i). Pending the decision of the appeal by the Privy Council, assessments for the years 1933-34, 1934-35, 1935-36, 1936-37, 1937-38 and 1938-39 were made. The [illegible]ssessee submitted the returns under protest and paid the tax demands. A[illegible]r the decision of the Privy Council, the assessee applied to the Commissioner under section 33 (corresponding to present section 33A) of the Act, requesting him to cancel the assessments and to grant a refund of the tax already paid. The Commissioner refused to reopen the assessments on the ground that the assessee did not keep the assessments alive by having them included in the reference to the Privy Council, and that the assessments had become final and conclusive. It was contended on behalf of the Department that so long as the assessments for the intervening years stood and were not modified in appeal, they were "final and conclusive" and no order could be made for refunding the tax paid, even though on the authority of the Privy Council judgment all the intervening assessments were not warranted by law. On the matter being taken up to the Lahore High Court, it was held that all assessments subsequent to the year 1932-33 were a nullity in view of the decision of the Privy Council, and that the Commissioner of Income-tax acted improperly in refusing to exercise the power vested in him to cancel the assessments and to order refund of the tax collected contrary to Law. It is true that the decision of the Lahore High Court has been set aside by the Privy Council in *C. I. T., West Punjab* vs. *Tribune Trust, Lahore* (1[illegible] T. R. 214. Their Lordships held that the assessments were not a[illegible] law and that the Commissioner could not be said to have acted 'imp[illegible]' under section 33 in not setting aside the subsequent assessments—"in the sense that it was contrary to equity and good conscience that money should be retained which ought never to have been paid". They did not accept the argument "that the assessee has a *right enforceable* against the Commissioner to require refund of tax paid by him upon grounds

of equity and good conscience, though the assessments had been made and the tax recovered in good faith". No doubt, as held by their Lordships the assessees had no claim in law for refund of the tax which subsequent decision of the Privy Council had showed the Department had no right to recover. Because, in their Lordships view, the remedies of the tax-payer were to be found within the four corners of the Act, the legal right to refund could not be recognised, and this position in law could not be affected by admitting "a collateral right—necessarily vague and ill defined—founded on principles of equity and good conscience". But we consider that this legal difficulty which prevented the Privy Council from ordering refund of the tax (which their Lordships appear to have recognised as due to the assessee on principles of equity and good conscience) requires to be removed. The Government stand on a somewhat different footing from a private litigant. It was not altogether fair for Government to attempt to keep the money which according to the Privy Council decision was recovered illegally merely on the technical ground that no appeal had been filed against the intervening assessments. If Government choose to take advantage of such technicalities, they cannot with any justification complain if the assessees follow the lead given by Government. In Courts of Civil Judicature it very often happens that pending the decision on a particular point in a test case, *e.g.*, as regards the payment of rent, subsequent recoveries of rent do take place. The final decision of the test case cannot affect such subsequent recoveries because they are governed by the principles of *res. judicata*. The position is somewhat different in dealing with a case like the Tribune Trust case. Here there is strictly nothing like the doctrine of *res judicata;* one of the parties is Government themselves, and it should be no part of the duty of the Department to refuse refund of the tax which, according to the final court of appeal, should never have been recovered. Where parties are the same and the point in dispute is the same, the later assessments must be treated to have been conditional, though they are not formally made the subject of pending proceedings each year. We recommend that a provision should be made in the law to give effect to this view. We realise, however, that in the converse case a corresponding provision should be made in favour of Government. It may be that the Appellate Tribunal or the High Court has decided against Government with regard to the assessment of a particular year and during the pendency of an appeal by Government in that matter subsequent assessments may have been made by the Income-tax Officer on the basis of the judgment still under appeal. So long as the appeal is not decided, the Income-tax Officer will not be in order in ignoring the judgment appealed against. Nor can the assessment be kept pending for more than 4 years, if the final decision is delayed beyond that period, because the proviso to section 34 allows the 4 years' period of limitation to be extended only when the reassessment is in pursuance of the appellate judgment and not to the assessments for intervening years. We recommend that a suitable provision should be made in such cases also, *viz.*, when the dispute is the same, relates to the same assessee and the final judgment in an earlier assessment proceedings indicates that the subsequent assessments should have been made on a different basis, it should be open to the Department to revive the subsequent assessment in the light of the final judgment and the time limit imposed by section 33B and section 34 should not be a bar in such cases.

We would like in this connection to give an extract from the 33rd Volume of Taxation, p. 289, quoting a comment from the Yorkshire Post under the heading "Human Touch in Tax Collectors":—

> "This much good has already come out of pay as you earn—it has convinced many that the income-tax collector is not, after all, an ogre seeking to squeeze blood out of a stone, but a helpful fellow who wants to be fair. More than this, he can be depended

upon to point out errors where silence might mean a gain for the Inland Revenue. A little instance of this was forthcoming recently. A Leeds man in filling up his income-tax return inadvertently placed an item of 13s. in the wrong column and so made it read £13—every penny taxable. The official dealing with the return saw the slip and sent a polite note asking if a mistake had been made. With great alacrity, the tax-payer made the necessary correction. I can go one better than this. A friend of mine was astounded to receive a cheque from the Inland Revenue with a letter almost apologetically explaining that he had been overcharged in some period far behind and here was the refund. Greater proof of fairness no man could wish for.

The Inland Revenue practice of drawing the attention of the tax-payer to the fact that he may be entitled to some relief he has not claimed, or that there is repayment due to him, is not, of course, an innovation that has been introduced since pay as you earn. On the contrary, it has been in operation for many years. Shortly after the last war the Inland Revenue introduced their system of automatic repayment. Under this scheme a tax-payer is notified in any case where, on examination of his annual return of total income, it is found that there is repayment due. In addition to this, it is also the Revenue practice to write to a tax-payer where, on examination of his return form, it appears that he has omitted to claim reliefs which have been claimed in previous years and allowed. Also in cases where it is discovered that a tax-payer has been overcharged for previous years it is usual for the Inland Revenue to point this out. Although there are many respects in which Inland Revenue administration can be criticised, there is abundant evidence that it is not Revenue policy to withhold from tax-payers reliefs or refunds to which, in the official view, there is clear entitlement. In these circumstances, the Revenue takes the initiative to see that the tax-payer's liability is correctly adjusted."

We would very much wish to see that this kind of helpful and fair attitude is adopted by the Department towards the assessees. It would undoubtedly evoke responsive co-operation and friendliness on the part of the assessees. The Income-tax Officer instead of being dreaded and shunned as at present, would then come to be looked upon as a friend and a guide. If the Department would wish to see the assessees in India come up to the level of the assessees in England in the matter of honesty and straight dealing, the Department and its officers must also in their turn adopt the helpful, sympathetic and just attitude which appears to be such a striking feature of the Income-tax Administration in England.

282. Our attention has been invited to a difficulty arising out of the wording of section 50 in connection with applications for refund of the tax when a claim arises for a Double Income-tax Relief. Under that section, a claim to any refund shall not be allowed unless it is made within 4 years from the last day of the financial year commencing next after the expiry of the previous year in which the income arose on which the tax was recovered. Under sub-section (2) of section 34 an identical period has been fixed for making original assessments under section 23. This fixation of the same time limit for filing an application for refund, as that for original assessment, gives rise to some difficulty. An assessee cannot ask for a refund unless his liability has been fixed by the making of assessments both in the Indian Union and elsewhere including Indian States. Nowadays, many assessments in India are in arrears for over two or three years and it may conceivably happen that assessment

for the "previous year", as defined in Clause (11) of sub-section (2), may be made almost at the close of the limitation period, which is also the period for filing application for a refund, arising out of the making of such assessment. Even if assessment in the Indian Union is made early enough to know what the liability under the Indian Income-tax Act is, the assessee would not be in a position to ask for a refund unless the foreign assessments are also completed within the period of limitation. Time would thus begin to run against an assessee even before his claim for a refund has materialised by a part of his income being assessed to Income-tax both in the Indian Union and in a foreign country. Government appear to have appreciated this difficulty in their Circular No. 1 of 1947 dated 30th April 1947. They said "that it had been brought to the notice of the C.B.R. that as the time limit of 4 years under section 34(2) of the Act for completing an assessment is the same as that under section 50 for making a claim for refund, there was not enough time left for filing a claim for double taxation relief in cases where the assessment is completed by about the close of the limitation period". The Board, however, thought that the time limit of 4 years was sufficient in ordinary cases; but, in order to obviate hardship in cases of delayed assessment, the Board directed that the Income-tax Officers should, with the previous approval of the Inspecting Assistant Commissioner, admit provisional claims made by assessees, whose assessments at one or both the places are pending at about the close of the financial year in which the time limit for making a regular claim for relief in respect there of would expire. The provisional claim has to be accompanied by a certificate of the Income-tax Officer stating that the assessment is pending before him. In our opinion, it is desirable to amend the law itself rather than to supply palliatives by means of Departmental Circulars, which, in some measure, leave discretion to the Departmental Officers even in cases of recognised hardship. A somewhat analogous difficulty arose in connection with the wording of sub-section (2) of section 34. Under sub-section (1) of that section, the assessment or reassessment proceedings had to be commenced within the period of 4 years or 8 years allowed by that sub-section and under sub-section (2) they had to be completed also within the same period of limitation. In the interim report which we made in February last, we stated that it would be meaningless to insist that a proceeding which could be started towards the end of the fourth year should necessarily be completed before the expiry of that year. On our recommendation, the legislature added a proviso to sub-section (3), which took the place of sub-section (2) as it then stood, that if a notice under sub-section (1) was issued within the time therein limited, the reassessment to be made in pursuance of such a notice may be made before the expiry of one year from the date of the service of the notice, even if such period should exceed the period of eight years or four years, as the case may be. Similarly, it would be meaningless to insist that an application for a refund should be made before the expiry of the period of 4 years commencing from the close of the assessment year when the assessment under section 23 itself is made towards the end of the fourth year. We, therefore, recommend that section 50 may be suitably amended so as to provide that an application for Double Income-tax Relief in cases falling under sections 49, 49A and 49D may be made within one year from the date of assessment either in India or in a foreign country, whichever is later, in spite of the fact that the period prescribed for making such claims under section 50 may have expired.

283. The Income-tax Act contains no provision which would safeguard revenue when, as a result of the order of the appellate authority, a refund of the tax already collected had to be made. If the Income-tax Officer were to carry the matter in appeal to the Appellate Tribunal, under section 33 of the Act, or the Commissioner of Income-tax were to ask for a reference to the High Court under section 66 of the Act, it is not unlikely that the order of the

Appellate Assistant Commissioner or the Appellate Tribunal, which made the refund payable, may be reversed. If the refund had already been made, Government might find it difficult to get back the refunded amount, if by that time the assessee should have left the country, or failed in business and was therefore, no longer in a position to pay. We accordingly framed Question No. 55 and enquired what safeguards could be devised to protect the interests of revenue in such cases. We pointed out that the law, as it stood, provided for only one possible contingency of this kind, namely, when Government appeal to the Privy Council against an order of the High Court, in which case under the proviso to sub-section (7) of section 66, the High Court can make an order authorising the Commissioner to postpone the payment of the refund. [Incidentally it seems to us that this substantive provision appears at the wrong place. It is enacted as a proviso to sub-section (7) of section 66, which authorises recovery of the tax in spite of the fact that a reference has been made to the High Court, i.e., pending the decision of the High Court on that reference. A proviso is normally designed to carve out an exceptioon to the substantive provision. In the present case it could have been enacted by means of a proviso to section 66, sub-section (7), that in certain circumstances the tax may not be recovered pending the decision of the High Court on the reference. But in point of fact it refers to *refund* (and not to the recovery of tax) and that, too, under circumstances which *follow* the decision of the High Court on the reference. It is difficult to see how this could be enacted in a proviso to sub-section (7). It seems to us that it should form an independent sub-section.]

284. The replies that we received were preponderatingly in favour of the view that some steps must be taken to guard the interest of revenue. Most of them suggested that no refund should be made until the period for appeal against the order of the Appellate Assistant Commissioner or the period for asking for a reference against the decision of the Appellate Tribunal expired. They further pointed out that if an appeal was filed, or a reference was made, the refund should not be made without taking security for due payment of the tax if the order necessitating the refund was set aside by the higher tribunals. Some suggested that if the refund was withheld pending a decision of the higher authority, and had to be paid eventually, the assessee should be entitled to get interest on the amount so withheld from the date when the refund became due to the assessee. A small minority were of the view that refund should be made as soon as it was due; that if Government were ultimately not able to recover the amount in pursuance of the decision of the higher authorities, this was a risk which Government must take in common with other creditors of the assessee. Some, however, agreed that, so far as non-residents were concerned, security may be taken before the amount was refunded to the assessee.

285. We share the view of the large majority who replied to our questionnaire that some steps must be taken to protect the interest of revenue. The argument that, if refund was to be withheld pending an appeal or reference by the Department, the tax should also not be collected from the assessee pending appeal by him is obviously fallacious. The tax refunded may not be subsequently recoverable owing to a change in the whereabouts or the financial position of the assessee. There can be no such fear on the part of the assessee that he may not be able to get a refund of his tax from Government if the assessment is modified or set aside in appeal or on reference. It is for this reason that under the Act the recovery of the tax is never in abeyance throughout the first and second appeals, or pending a reference to the High Court [section 66(7)]. We have elsewhere suggested (paragraph 261) stay of recovery in certain cases pending decision on appeal, revision on reference. There is in certain circumstances real danger of the amount refunded becoming

subsequently irrecoverable. Special provision appears to have been made for appeals pending before the Privy Council probably because it was thought that there was likely to be considerable delay in the disposal of such appeals. But the risk involved in making a refund in other cases is not negligible. In our opinion the refund may be withheld until the period for filing an appeal, or for making a reference to the High Court has expired. The question of withholding refund or allowing it to be paid after the appeal has been filed or reference obtained should, we think, be left to the discretion of the superior authortiy, namely, the Appellate Tribunal or the High Court, as the case may be. If an appeal is filed, or a reference to the High Court is obtained, the Income-tax Officer or the Commissioner, as the case may be, should file a separate application stating reasons why it would be inexpedient in the interest of the revenue to allow refund being made under the order complained of. On the analogy of the provisions of Order 41 of Rules 5 and 6 of the Civil Procedure Code, the Appellate Tribunal or the High Court, as the case may be, on sufficient cause being shown, should either order stay of the refund or permit the refund being made on the assessee furnishing security to the satisfaction of the authority making such order for the restitution of the amount so refunded. No such order should be made unless the authority, after notice to the assessee, is satisfied (1) that substantial loss may result to Government unless such an order were maed, and (2) that the application has been made without unreasonable delay. It should, however, be competent for that authority to make such an order *ex parte* pending the hearing of the application We would also provide that if the whole or any part of the refund amount withheld has to be ultimately paid to the assessee, the assessee should be entitled to interest thereon at 3 per cent. per annum from the date when such refund became due to the date of the actual payment.

CC.—Powers of Income-tax Officers

(Questions 52, 53, 58 & 59)

286. In the course of our interviews with the officers of the Department, it was suggested that the powers that Income-tax Officers at present possess are wholly inadequate, and that additional powers should be given to them. Indeed the necessity for appointing this Commission arose from the fact that Income-tax Officers could not, with the powers they possessed, come to a correct estimate of the income of the assessees and there had been tax evasion on a most impressive scale. In order that the Commission may have a better chance of success, the Income-tax (Investigation Commission) Act had to be amended in February this year and again very recently by an Ordinance to arm the Commission with the necessary powers. The question naturally arose whether some, if not all, of the powers of the Commission should not form part of the normal armoury of Income-tax Officers. We accordingly asked for the views of the public as regards the proposal that enhanced powers should be given to Income-tax Officers to enable them to gather relevant information, particularly (1) to deal effectively with persons suspected of having black-market dealings; (2) to enter business premises and inspect the accounts kept therein, place identification marks thereon and make copies therefrom, and if the officer has reason to think that they may not be forthcoming when required, to impound them; (3) to make a search of places where there are reasonable grounds for believing that relevant books and records have been kept; and (4) to call for relevant information from banks and other business houses.

287. The replies that we received were generally against the grant of fresh powers. Some argued with regard to the first point in Question 52 that it was no business of the Income-tax Department to deal with black markets, and that the Police and the C.I.D. may well be left to tackle that problem. Others contended that the existing power, if properly used, were adequate

for the purpose. Many, however, asserted that the enlarged powers would mean only additional instruments in the hands of Income-tax Officers for harassing innocent assessees. Some suggested that the better method would be to increase the staff, improve their efficiency and give them adequate salary.

288. With regard to the first objection, we may say at once that it is based on a complete misunderstanding of the proposal contained in clause (i) of the question. Most people understood the suggestion as meaning that it was intended to give powers to Income-tax Officers to stop black-market transactions. Of course there was no such intention as it was unthinkable that the Income-tax Officers should undertake such duties. It is none of the business of Income-tax Officers to stop black-market dealings; but, as such transactions do exist, the problem was how to bring the money earned as a result of such transactions into taxation by enabling the Income-tax Officers to gather relevant information for dealing effectively with persons suspected of having black-market dealings. Such transactions are never brought into books, and it was in order to ascertain whether any practical methods could be suggested to achieve this purpose that the question was framed.

289. With regard to the general objection raised, two questions arise for consideration: (1) whether such powers are necessary for Income-tax Officer, and (2) if so, whether they should be conferred upon them.

290. So far as the first question goes, our considered opinion is that such powers are essential for Income-tax Officers. Our experience so far in connection with the investigation of cases referred to us has been something in the nature of an eyeopener, and has not been such as to induce us to believe that without such powers it would be possible for Income-tax Officers to ascertain the truth with regard to the assessee's income in certain types of cases. During the last 8 or 10 years enormous profits were being made and with the high incidence of taxation, particularly at the higher levels, the temptation for resorting to dubious means for screening profits was very great. As a result methods were evolved for suppressing profits from the notice of Income-tax Officers on which it would be imprudent, for obvious reasons, to dilate in this report. We echo the observations of the Royal Commission of 1920 in paragraph 628 of their report: "It is unnecessary and indeed undesirable to describe in detail the various methods that are adopted by the dishonest tax-payers; to do so would be to place a guide to improper practices in the hands of susceptible persons but the evidence as a whole fully convinced us that there is a serious loss of revenue caused by fraud, negligence and ignorance and that there is a considerable minority of taxpayers who, tempted more than ever by a high rate of tax, deliberately seek to cheat their fellows by understating their liability to assessment". It is hardly to be expected that the temptation felt and the technique developed by the tax dodgers would disappear so soon after the end of the war. The temptation is still there. As we have stated before, the justification for this Commission and the necessity for asking the Legislature to confer wide powers upon us are in themselves arguments for conferring on Income-tax Officers higher powers than they possess at present. If Income-tax Officers had had power to enter business premises, to inspect accounts and, if necessary, to impound them and to make a search of places where they had grounds for believing that relevant books and records had been kept, it might have been comparatively easier to detect the existence of account books, both spurious and genuine, in which current accounts were being maintained. Normally, assessment is made several months, and sometimes a year or two, after the end of the accounting year. By that time the real account books are safely put away and the Income-tax Officer has nothing to go by except the spurious account books produced by the assessee. We think, therefore, that such powers are necessary for Income-tax Officers for proper discharge of their duties.

291. Having come to the conclusion that these powers are necessary, we next consider the question whether there is any reason why they should not be conferred on Income-tax Officers. Many replies which opposed the grant of these powers were influenced by a mistrust of the officers of the Department. Although we would be slow to deny that there are some officers who may abuse their powers occasionally, we would urge for a more sympathetic understanding of the difficulties of Income-tax Officers. While there are undoubtedly a large number of assessees who would co-operate with Income-tax Officers and pay their just dues to the State, there are unfortunately others who would strive their utmost to evade or avoid payment to the State of the taxes due from them, especially when the tax bears so heavily on higher ranges of income. Against such persons the Income-tax Officer has to fight a singlehanded battle, combining in himself qualities of a policeman, an accountant, a lawyer and a judge. Moreover, no Government can carry on, if it establishes a department for a specific purpose and then mistrusts the officers of that department. We do not deny that in some cases powers may be abused; but if the necessity for conferring those powers is established, then the possibility of their misuse is no reason for denying those powers. It would merely emphasise the necessity of taking care to see that those powers are not in fact abused.

292. We would note in this connection that under the recommendations of the Central Pay Commission a very large number of Income-tax Officers would be classified in Class I, which is the highest service of an all-India nature. The new recruits to this service now undergo an intensive course of training before they are actually assigned work as ordinary Income-tax Officers in charge of important cases. With the status and efficiency thus secured, we hope that there would be very few cases of abuse of these powers. If we cannot trust Class I officers with such powers, then we apprehend a gloomy future for the administrative efficiency of this country. We would note in this connection that officers with much lower status, educational qualifications and training possess such powers in other departments of Government, e.g., Customs, Excise, Sales Tax, Rationing, etc. Further, under the new set up of things, when almost every assessee would know his rights and would be in contact with lawyers and leaders of public opinion, chances of such misuse of powers by Income-tax Officers would be comparatively small. We hope that the mere existence of these powers would be a sufficient deterrent without it being necessary for the officers to exercise those powers.

293. But we agree that there should be sufficient precautions taken against the powers being abused. We have considered various forms which such precautions might take. For instance, one way is to limit the powers to officers of certain seniority or to certain selected officers. Secondly, it might be suggested that the previous approval of the Inspecting Assistant Commissioners should be taken before such powers are exercised by Income-tax Officers. Thirdly, we might insist on Income-tax Officers making a report to the Inspecting Assistant Commissioner immediately after they have resorted to the use of those powers. So far as the first alternative is concerned, we do not think it practicable. Income-tax Officers have got territorial jurisdictions and if only some of those officers are specially empowered, we can never be sure that the necessity for the use of those powers will arise only in the jurisdiction of those officers and not in that of other officers who do not possess such powers. If our suggestion that there may be multiple charges with more than one officer of different grades is accepted, this argument will lose much of its force. The second alternative would ordinarily be practicable at places which are the headquarters of the Inspecting Assistant Commissioner. At such places it may be possible for an Income-tax Officer to consult his Inspecting Assistant Commissioner unless he happens to be on tour. But if an emergency should arise at a place which is not the headquarters of the Inspecting

Assistant Commissioner, prior consultation with him would not always be feasible. We, therefore, recommend that whenever possible action under clauses (2) and (3) above should be taken with the previous concurrence of the Inspecting Assistant Commissioner. In other circumstances, however, we suggest that recourse may be had to the third alternative. As soon as the powers mentioned in clauses (2) and (3) of our question, viz., to enter business premises and to make a search, have been exercised, a report should be made to the Inspecting Assistant Commissioner stating the reasons that called for the exercise of those powers and the result actually obtained by their use. It will be the business of the Inspecting Assistant Commissioner to see that the powers are sparingly used and after circumspection. When the powers are misused, it would be within the competence of the Inspecting Assistant Commissioner to guide the Income-tax Officer in the proper exercise of those powers and, if necessary, to warn him.

294. If Income-tax Officers are armed with these powers, they would be of value in enabling them to deal with black-marketeers. This proposal, coupled with the institution of machinery for contemporaneous collection of statistical material and data about the trend of prices, information regarding fortunes made in business, and the power to call for relevant information from the Banks and other business houses should, we think, equip the Income-tax Officer with sufficient authority and materials to deal adequately with all the cases he has to handle.

295. Any criticism that we are recommending the conferring of far too wide powers on Income-tax Officers can, we think, be best answered in the words of the Royal Commission on the Income-tax (1920). In paragraph 642 of their report, they say:—

> "It is, we fear, inevitable that suggestions which tend to strengthen the Administration will meet with a certain amount of opposition, some of it genuine, though much of it unworthy and proceeding from persons whose sense of citizenship is imperfectly developed. But we cannot lose sight of the fact that the Government is in effect a partner, so far as appropriation of profit is concerned, in every business, to the extent of anything upto 50 per cent. as regards Income-tax and Super-tax alone; and the powers we have suggested for the verification of returns would certainly be admitted to be reasonable for any partner in a firm, who desired to ensure that a correct appropriation of profits should be made to his own personal account. Moreover, the existence of proper powers of investigation and punishment would be so deterrent as to render the exercise of those powers unnecessary in a great majority of cases."

296 In Question No. 53 of our Questionnairs we enquired whether it would not be desirable to have a provision in the statute itself specifically authorising officers of the Income-tax Department to call upon assessees to submit a total wealth statement at any time they may consider it necessary, as we thought that such statements would be of use to the Department in assessing the correct income of the assessee.

297. By a total wealth statement, we mean a statement showing all the assets that an assessee owns at a particular point of time, preferably the end of his "previous year" along with the liabilities incurred in acquiring those assets. When the assessee is a Company or other person maintaining accounts on the mercantile system of accounting, its Balance Sheet would represent its total wealth statement, as a Balance Sheet under section 132 of the Indian Companies Act has to "contain a summary of the property and assets and of the capital and liabilities of the Company giving such particulars

as will disclose the general nature of those liabilities and assets and how the values of the fixed assets have been arrived at". Such a Balance Sheet has been made compulsory in the case of a certain class of assessees, under Rule 19 of the Indian Income-tax Rules, which prescribes a form of notice to be issued annually to assessees. In part 4 of that notice under the heading "particulars of income from business, profession or vocation" it is mentioned that "if the accounts are kept on the mercantile accountancy or book profit system, a copy of the profit and Loss Account and Balance Sheet must be attached to this return. . . . ." The present proposal is only an extension of such a provision to assessees other than those covered by that paragraph.

298. The opinions that we received were, as usual, divided, but, on the whole, the weight of opinion was in favour of vesting Income-tax Officers with such powers. A fairly large number of replies, including those of important Chambers of Commerce, were of the opinion that this power was already implicit in the powers which an Income-tax Officer possesses under section 37 of the Act. A few were of the opinion that the power may be exercised subject to the sanction of the Commissioner or only in a few specified cases. Those, who were against the proposal, opposed it on the ground that the power might be exercised by Income-tax Officers indiscriminately to the harassment of assessees. Others opposed it for the reason that the Income-tax Officer was only concerned with the income and not with the wealth of the assessee.

299. In agreement with the majority opinion, we are of the view that it would be an advantage to have a specific provision enabling Income-tax Officers to call for such total wealth statements whenever they consider it necessary so to do. We are not impressed with the argument that the Income-tax Department is only concerned with the income and not with the total wealth. The accession of wealth is often the result of the income that a man earns, and such accession would, in many cases, be a fair index of the income earned by him during preceding years. It is true that, under section 37 of the Act, the Income-tax Officer has power to enforce the attendance of any person, to examine him on oath and to compel him to produce certain documents. It is likely that by means of questions and answers it would be possible for an Income-tax Officer to ascertain the total wealth of the assessee, but it would be a distinct advantage if a specific provision is made enabling the officer to call upon the assessee himself to furnish a total wealth statement.

300. There are a large number of cases where the increase in the total wealth of an assessee can be the only means of checking his income. For example, where an assessee keeps no accounts, or where his business accounts are not closed, an Income-tax Officer has very little to go by, except making a guess as to what the total income of the assessee might be. If, on the other hand, he did have before him a statement showing the increase in the total wealth of the assessee, that might be some indication of his income in the preceding years. This kind of check is the only possible means of assessing the correct income of persons who generally maintain no accounts such as salary earners having other sources of income, professional men, etc. It would also be of assistance in finding out the income from speculation, commission agencies, etc. of persons who do not deal in stock-in-trade. People, who do business in India but who choose to invest their income in foreign countries, would also come under a check as to the correct returns of total income, if such returns can occasionally be compared with statements of their wealth. As stated in the Registered Accountant (February 1948 issue) on this point, "The Tax Department will then have a guide to judge an assessee's status in life and to estimate his means roughly and to check upon his return of income. Such a return revised annually would also be an invaluable help to the Tax Department when Death Duties are introduced".

301. We recognise that there is some danger in calling for such total wealth statements unless the Income-tax authorities are in a position to check their correctness. If the statements were not properly scrutinised and subjected to necessary checks, they would by the very passage of time obtain a certain degree of sanctity. Moreover, obtaining such statements on oath would, as a natural consequence, throw some burden upon the Income-tax Officer to prove their incorrectness, and it could be argued, with a certain degree of plausibility, that once a statement on oath has been obtained from an assessee as regards his total wealth, such statement should be accepted as *prima facie* correct, unless the Income-tax Officer were in a position to prove it to be false. It is conceivable that in a large number of cases it may be beyond the power of an Income-tax Officer to do so.

302. We, therefore, think that calling for such statements should not be regarded as a routine process to be gone through every year or in the case of every assessee. The power should, in our opinion, be exercised occasionally and with discrimination. We suggest that whenever the Income-tax Officer considers it necessary to call for such statements, he should record in writing his reasons for so doing. If this procedure were followed, it would be possible for an Inspecting Assistant Commissioner to judge whether the power has been judiciously exercised or not. We do not think it should be necessary for an Income-tax Officer on each occasion to consult his Inspecting Assistant Commissioner before he exercises this power. Even an *ex post facto* check will, in our opinion, be sufficient and will place an Income-tax Officer on his guard against indiscriminate exercise of the power.

303. If such statements on oath are to be called for, it would be necessary to make a specific provision in section 52 of the Act for the prosecution of the assessee who makes a statement which is false, and which he knows or believes to be false, or does not believe to be true. Section 52, as it stands, declares the making of false statements punishable only where the statement occurs in the verifications mentioned in certain sections of the Act enumerated therein.

304. Although a critical examination of the accounts of an assessee is a valuable method of making correct assessments, it suffers from the defect that the examination can proceed only on such material as the assessee chooses to bring into his accounts. Information to be obtained from banks and other business institutions may serve as a valuable check in the examination of such accounts, but the investigation would be more effective if information could also be obtained as regards the private transactions and financial dealings of the assessee. We had, therefore, to consider whether some means could not be found of facilitating the obtaining of such information. We accordingly framed a question (Question No. 58), enquiring whether it would not be desirable for the Income-tax Department to reward informers for valuable information given to the Department in respect of tax evasion, and, if so, what safeguards could be suggested so that the system may not be availed of by blackmailers.

305. The general consensus of opinion was against the proposal. If some kind of definite inducement in the shape of a reward was placed before persons having information about the private dealings of an assessee, it was not impossible that such persons would resort to the practice of blackmailing the assessee and trying to extort monetary consideration for refraining from giving the information to the Department. Some replies stated that the proposal of giving rewards would result in creating a flock of touts and that respectable people who have information to give would not care to give it. Other replies stated that it was far more desirable that Government should lose some money in the way of taxes than that it should encourage a widespread practice of betrayal or blackmail.

306. We were aware that the proposal was likely to result in the persons concerned resorting to blackmail, and that is why we enquired what safeguards could be suggested against such undesirable consequences of the proposal. But the system of giving rewards is not as deserving of condemnation as has been made out in the replies received by us. It is by no means a novel suggestion. Section 32 of the Inland Revenue Regulations Act of 1890 enacts that the Commissioners of Inland Revenue may, at their discretion, reward any person who informs them of an offence against the Inland Revenue, or assists in the recovery of any fine or penalty. The reward is not to exceed £50, except with the approval of the Treasury. The reward is entirely in the discretion of the Revenue and an informer is not entitled to claim a reward, nor is it within the power of the Revenue to enter into any agreement for the payment of a specific sum in return for the information to be imparted to them. In *Riach v. Lord Advocate* (18 Tax Cases, p. 18) it was held that under the section referred to above the Legislature intended that the Commissioners were to have complete freedom in the matter and were not entitled to make any bargain with informers. Therefore, anyone who proposes to act the part of an informer must take his chance as to what reward, if any, he will get (see "Taxation" Volume 38, p. 271). In paragraph 336 of their Report, the Royal Commission on Income-tax recommended in 1920 that the limit of £50, which was the highest amount the Board could award to an informer without express Treasury sanction, was unnecessary and should be withdrawn, and that any anticipated expenditure for the payment of informers should be included with other costs of administration in the Revenue Estimates. In the United States of America, any person, not an officer or employee of the United States, who furnishes to the Commissioner or any Collector original information leading to the recovery from any other person of any penalty under section 3617 of the Internal Revenue Code, can be rewarded and paid by the Commissioner a compensation of one-half of the penalty so recovered as determined by the Commissioner. This provision relates to the payment of reward to informers with respect to illegally produced petroleum. In India, it is the practice of the Customs Department to reward an informer for giving information which leads to the detection of articles sought to be smuggled into the country and we are informed that the reward is usually a percentage of the duty recovered as a direct consequence of the information received. Thus, there are other systems of legislation which give statutory recognition to the giving of rewards for information having a direct bearing on the tax evasion. But we recognise that the system is likely to be abused and that a general invitation to informers with the inducement of a reward may actually result in more harm than good. It also appears from the replies that we received that public opinion is against such a proposal, and we, therefore, make no recommendation in that behalf.

307. In Question No. 59 we enquired what the appropriate procedure should be when an assessment proceeding started before one Income-tax Officer has to be completed before another, either because the case is transferred from one Income-tax Officer to another, or because one Income-tax Officer is on transfer, retirement, etc., succeeded by another. We desire to know whether in such cases the proceedings could be continued from the stage which they had already reached, or whether it was necessary or worth while to have a re-hearing, either in all cases, or, at any rate, in cases in which the assessee so desired.

308. The views that we received were divided. Some thought that the proceedings should be continued from the stage which they had reached before the first Income-tax Officer; others thought that in all cases there should be a hearing *de novo*. Some others steered a middle course and suggested that the rehearing should take place only if the assessee so desired.

309. The proceedings before an Income-tax Officer are of an informal

nature and no detailed record is kept of all that transpires before an Income-tax Officer. The record is nothing like so complete as the records of a Civil Court. That being so, it may not always be easy for the second Income-tax Officer to proceed from the stage which the proceedings have reached before the first Income-tax Officer. Moreover, the assessee himself may wish, or the second Income-tax Officer may himself think it desirable that the proceedings should be heard *de novo* by him. We think that in the ordinary course the proceedings may be continued by the second Income-tax Officer from the stage which they have already reached, but in case the assessee so wishes, or the Income-tax Officer himself so desires in order to do full justice to the case, the proceedings should be started *de novo* in the matter of actual recording of the evidence. The preliminary steps like the issue of notice etc. need not be gone through over again. We, however, desire to impress on the Central Board of Revenue that Income-tax Officers should be directed, as far as possible, to complete the cases on their hands before relinquishing charge, especially cases where the inquiry has proceeded to an appreciable extent. This may not always be feasible, for an Income-tax Officer very often has several cases on his hands, and difficulty may arise particularly in Central circles. But if the cases cannot be completed before the first Inome-tax Officer relinquishes charge, they should be continued in the manner suggested above.

DD.—Inspecting Assistant Commissioner.

(Question No. 56)

310 In the course of our informal discussions with the representatives of the legal profession, Registered Accountants, etc., at different provincial centres, we heard a complaint voiced with considerable force that Inspecting Assistant Commissioners interfere unduly with the work of Income-tax Officers in pending cases. We were also told that objection was taken in some cases to the presence of the Inspecting Assistant Commissioner during inquiries held by an Income-tax Officer on the ground that there was no statutory warrant for his presence. We, therefore, enquired in Question No. 56 whether it would not be advisable to define in the statute itself the powers and duties of Inspecting Assistant Commissioners and the Director of Inspection in view of the prevailing practice of their inspecting assessment records and advising Income-tax Officers in matters connected with current assessments.

311. With a few exceptions (of persons who had retired after service in the Department), the general consensus of opinion was in support of the complaint. It was stated that as a result of the interference of Inspecting Assistant Commissioners in pending cases and the obligation that the Income-tax Officers naturally felt to carry out any advice given by the Inspecting Assistant Commissioners, Income-tax Officers had lost all initiative and sense of personal responsibility. It was further stated that owing to the detailed supervision of Inspecting Assistant Commissioners in pending assessments, Income-tax Officers felt bound to consult them at every step and thus they merely registered the views of Inspecting Assistant Commissioners even where they did not themselves agree with them. The replies complained that assessees were not aware of the private consultations taking place between the Income-tax Officer and the Inspecting Assistant Commissioner, and could not, therefore, place their point of view before the Inspecting Assistant Commissioner and thus satisfy him on any point that might go against them. For this reason they considered that Inspecting Assistant Commissioners had become extremely unpopular and suggested that these posts should be abolished. If, however, the posts were to be retained, they thought that Inspecting Assistant Commissioners should merely do administrative and inspection work without having any hand in the assessments pending before Income-tax Officers. Some thought that Inspecting Assistant Commissioners

may give advice where it has been asked for by Income-tax Officers provided that such advice was not to be regarded as binding on the officers. Some replies suggested that if Income-tax Officers were not, on their own initiative, equal to dealing with big cases, such cases might be dealt with by Inspecting Assistant Commissioners themselves. Where advice was sought for from and given by Inspecting Assistant Commissioners, the replies stressed the propriety of Inspecting Assistant Commissioners giving a hearing to assessees before any such advice was given. Some of the replies drew pointed attention to the indifferent attitude adopted by Inspecting Assistant Commissioners when an assessee approaches them with a request to advise the Income-tax Officer on some point which the latter proposes to decide against the assessee. They complained that although Inspecting Assistant Commissioners give various directions to the Income-tax Officers behind the back of the assessee, the Inspecting Assistant Commissioners, when approached by an assessee to give a direction in his favour, always put forward the excuse that under the Act their powers are limited. The gist of most of the replies was that the Income-tax Officer should function as an entirely independent quasi-judicial officer and that if any decision of the Income-tax Officer should go against the Department, it should be within the power of the Inspecting Assistant Commissioner concerned to appeal against it to the Appellate Assistant Commissioner. Some of the replies even went so far as to suggest that an Inspecting Assistant Commissioner should be placed in the position of a Surveyor in England and should represent the Departmental point of view before the Income-tax Officer.

312. Prior to 1939, there were Assistant Commissioners who combined in themselves both inspecting and appellate duties. This arrangement was obviously open to the criticism that the right of appeal was illusory as in many cases the assessments themselves were made by the Income-tax Officers in consultation with the same Assistant Commissioners before whom the appeal was to go. The Ayers' Committee noticed this defect in the arrangements as they stood then, and recommended that there should be bifurcation of the two duties of Assistant Commissioners and that they should be entrusted to two separate sets of officers. They suggested that the Assistant Commissioners hearing appeals (to be designated as Appellate Assistant Commissioners) should be relieved of administrative functions. In order to secure proper performance of supervisory functions, they recommended that full-time inspecting officers of the Assistant Commissioner's grade should be appointed with no appellate jurisdiction. It was hoped that these inspecting officers would be responsible to the Commissioner to see that the work in the circles under their control was effectively performed, and that it would be their duty, in addition to making thorough inspection of the circles under their control, to give Income-tax Officers advice and instructions. It was expected that an Income-tax Officer would refer to his inspecting officer any major point of doubt or difficulty before completing assessment proceedings. It was hoped that the inspecting officer, with his wider experience, would be able to guide the Income-tax Officer as to the principles on which the computation of profits should be made in dealing with cases presenting unusual features The inspecting officers were also expected to deal with such matters as the general organisation of the office, the control of the office staff, settlement of refund claims in reasonable time, and the extent to which the convenience of the public was consulted in such matters as arrangements for interviews, calling for the books of accounts, etc.

313. The Amendment Act of 1939 implemented this part of the Report of the Ayers' Committee. The duties and functions of Assistant Commissioners ircated and were entrusted to separate sets of officers—one set of Commissioners (designated as Appellate Assistant Commissioners)

doing purely appellate duties with no inspecting or supervisory work and the other (styled as Inspecting Assistant Commissioners) doing only inspection and supervisory work with no appellate jurisdiction. The powers and duties of Inspecting Assistant Commissioners, however, were not defined with any degree of completeness or accuracy. They have statutory powers under certain sections, such as section 23A, section 28, section 52, etc. But apart from their statutory duties, the general duties of the Inspecting Assistant Commissioners have nowhere been defined. Inspecting Assistant Commissioners follow the orders and directions of the Central Board of Revenue as they are bound to do under sub-section (8) of section 5 of the Act. It is this undefined nature of their powers and duties that has led to the present complaint. In their capacity as advisers and guides of Income-tax Officers, they in fact give directions as to what the Income-tax Officer should or should not do even in pending cases, though their advice has not been asked for. The Income-tax Officer naturally feels constrained to follow the directions of the Inspecting Assistant Commissioner irrespective of whether he himself agrees with those directions or not. Indeed we are informed that it is the practice prevailing all over the country that in all assessments in Central circles and in important cases in other circles, draft orders have to be submitted by Income-tax Officers for the approval of Inspecting Assistant Commissioners, and it is only when they are so approved that they can be issued by Income-tax Officers as their own orders. Where the Inspecting Assistant Commissioner differs from the view taken by the Income-tax Officer, the latter has perforce to carry out the amendments suggested by the Inspecting Assistant Commissioner and to issue the order as his own order. In such cases it will be idle to pretend that the assessing officer is the Income-tax Officer and not the Inspecting Assistant Commissioner.

314. In our opinion there is a good deal to be said in justification of the complaint voiced in the majority of the replies, and we think that the present set-up needs alteration. One of the suggestions that was made to us was that, as in England, non-official element should be associated in the making of assessments to replace the advice given by Inspecting Assistant Commissioners. In England in a large majority of cases assessments are agreed to between the Surveyor representing the department and the assessee and such agreed assessments merely receive the imprimatur of the Commissioners. In the few cases where there may be no agreement between the assessee and the Surveyor, the matter goes before the General, Additional or Special Commissioners, as the case may be. Most of these Commissioners are non-official persons of status and respectability and command the confidence of the general public. It has, therefore, been suggested that such a non-official agency should be set up for making assessments and that in the assess-proceedings before such agency the Income-tax Officer should represent the Department. We do not consider that this suggestion is feasible. Although we do not suggest that persons of respectability, standing and integrity may not be available in this country, such persons may not be forthcoming in sufficient numbers at every place and the experience of the Jury system in India must make one pause before laying the task of making assessments on non-official agency. The second suggestion which has been made to us is that the officer who makes the assessment should be a person different from the officer who makes investigation into the case. We do not consider that even this would be practicable as a general rule without increasing the staff to an enormous extent. Our experience of investigation into the cases that have been referred to us has made us realise what a difficult task is entrusted to an Income-tax Officer, who has to investigate into cases and also decide them in a semi judicial capacity. We consider, that on the whole, the Income-tax Officers have discharged their duties in a commendable manner. In the large majority of cases, therefore, assessments

may continue to be made by the Income-tax Officer as at present, but we think that there should be no interference whatsoever by the Inspecting Assistant Commissioner in respect of pending assessments. The recent amendment made by the insertion of a new section 33B in the Act enabling the Commissioner to exercise his powers of revision where the interest of Revenue has suffered as a result of the order of the Income-tax Officer, will remove any possible objection on the score of Inspecting Assistant Commissioners' powers being withdrawn in respect of pending assessments. There was perhaps some need for such powers formerly as, prior to this amendment, there was no remedy for the Revenue if the Income-tax Officer's decision went against it. No such necessity now exists. Our proposal will make the Income-tax Officer self-reliant and instil in him a proper sense of responsibility for all the orders he makes. The lack of guidance from Inspecting Assistant Commissioners will not be a serious handicap as most of the big cases are even at present handled by senior officers of considerable experience and standing and there is not perhaps much to choose between such officers and junior Inspecting Assistant Commissioners. If a case is of any special difficulty, it seems to us desirable that the whole assessment should be done by the Inspecting Assistant Commissioner himself. Under sub-section (5) of section 5 it is open to the Commissioner of Income-tax, with the approval of the Central Board of Revenue, to direct, by a special or general order in writing, that the power conferred on Incomt-tax Officers shall in respect of any specified case or class of cases be exercised by Inspecting Assistant Commissioners. It does not appear that the provisions of this sub-section have been taken advantage of by the Department. If, as we suggest, some specially important cases are taken up by the Inspecting Assistant Commissioner himself, the experience so gained may be some guide in deciding whether this system should be extended. Such cases should be investigated by the Income-tax Officer but the assessments should be made by the Inspecting Assistant Commissioner, it being provided that from the order of the Inspecting Assistant Commissioner appeal will lie direct to the Appellate Tribunal.

315. If, however, an Income-tax Officer considers that in a particular case he would like to have the advice of his Inspecting Assistant Commissioner, we do not wish to deny him the opportunity to consult the Inspecting Assistant Commissioner. But, we think, there is considerable force in the grievance of the assessees that in such cases they have no knowledge as to the points on which the private consultation takes place between the Income-tax Officer and his Inspecting Assistant Commissioner. We would, therefore, recommend that in such cases and in all cases where an Inspecting Assistant Commissioner exercises power specifically vested in him by the statute, the Inspecting Assistant Commissioner should give an opportunity to the assessee to place his point of view before him, and after hearing him if he appears the Inspecting Assistant Commissioner may give such advice to the Income-tax Officer, or pass such order, as he thinks fit. We cannot too strongly disapprove of the practice, which seems very much in vogue at present, of the draft orders of Income-tax Officers being, in the first instance, submitted to the Inspecting Assistant Commissioner for approval and then issued by the Income-tax Officer as his own orders after carrying out such directions as the Inspecting Assistant Commissioner may have chosen to give.

316. So far as the Directorate of Inspection is concerned, these officers are nowhere mentioned in the Act and have no statutory recognition or powers as such. They form part of the office of the Central Board of Revenue and

exercise powers of inspection on behalf of the Board. They supervise the work of the Inspecting Assistant Commissioners on the technical side—see the inspection reports of Inspecting Assistant Commissioner on the work of the Income-tax Officer and give directions as to how such inspections should be made. We have commented elsewhere (para. 393 et seq.) on the utility of maintaining this class of officers, but our remarks with regard to the inadvisability of their giving directions to Income-tax Officers in pending cases would equally apply to them.

EE.—Appellate Assistant Commissioners

(Question 57)

317. In the course of our inquiries, we received frequent representations that Appellate Assistant Commissioners are not able to bring to bear on the appeals heard by them an independent judgment and that their decisions are influenced to some extent by a predilection in favour of the revenue. This was attributed to the fact that Appellate Assistant Commissioners are subject to the general control of the Central Board of Revenue and that their advancement in service depends on the good opinions of the Commissioners and of the Board. The only avenue for promotion open to them at present is to Commissionerships, appointment to which rests entirely on the estimate that the Board forms of their capabilities and on the reports made by the Commissioners. In these circumstances, there was some ground for misgivings that Appellate Assistant Commissioners might be anxious to please the executive heads of the Department and that their decisions in appeals might, to some extent, be influenced by this consideration. We accordingly asked (Question No. 57) for the views of the public on a proposal that Appellate Assistant Commissioners should be removed from the control of the Central Board of Revenue and placed under the control of the Ministry of Law We also enquired whether there should not be only one appeal on questions of fact, *viz.*, to Appellate Assistant Commissioners in certain classes of cases, and direct to the Appellate Tribunal in others. We mentioned that this proposal would correspond with the practice in the ordinary civil judicature It appeared to us that a provision for two appeals on a question of fact was an unnecessary luxury, and we put forward for consideration a scheme under which in certain classes of cases there would be a first appeal on questions of both fact and law to the Appellate Assistant Commissioner and a second appeal on a question of law only to the Appellate Tribunal, and in other cases a first appeal on questions of fact and law direct to the Tribunal and a reference on a point of law to the High Court.

318. As regards the first point, opinion was practically unanimous that Appellate Assistant Commissioners should be removed from the control of the Central Board of Revenue. With regard to the second question, the majority of the replies were not in favour of the change suggested, and desired that the present practice of having two appeals both on questions of fact and law should continue.

319. Prior to 1939, there were not, as at present, two sets of Assistant Commissioners and a large part of the work of Assistant Commissioners, consisted of hearing appeals against the decisions of Income-tax Officers. They had also to supervise the work of Income-tax Officers. As a result of the recommendations of the Ayers Committee, the Appellate and supervisory functions were bifurcated and each was entrusted to separate sets of Assistant Commissioners. Although this step was one in the right direction and gave a sense of reality to the appeals heard by Assistant Commissioners who were expected to be absolutely free to give their unfettered decisions, it seems to us that the experiment then begun should be carried forward to its logical conclusion; otherwise the scheme would only amount to a half-hearted attempt to remove the influence of the

executive as long as Appellate Assistant Commissioners continue to be subordinate to the Central Board of Revenue. Although under the proviso to sub-section (8) of section 5, no orders, instructions or directions can be given so as to interfere with the discretion of Appellate Assistant Commissioners in the exercise of their appellate functions, the public will be slow to give them credit for independence and impartiality. We have no reason to think that Appellate Assistant Commissioners have not been impartial in the discharge of their duties or that the independence of their judgement is vitiated by any considerations irrelevant to the decision of the appeal. But on the principle that not only should justice be done but that it should appear to be done and should inspire confidence in the persons concerned, we think that the present system requires alteration. We think that the experiment begun in 1939 should be carried forward and Appellate Assistant Commissioners should be removed from the control of the Commissioners and the Central Board of Revenue and placed under the Appellate Tribunal Their leave, transfer and posting should be in the hands of the Tribunal.

320. A suggestion has been made that the experiment requires for its logical completion that Appellate Assistant Commissioners should be recruited from among the senior Subordinate Judges. While we are desirous of encouraging a judicial outlook in Appellate Assistant Commissioners we feel that the nature of an Appellate Assistant Commissioner's work requires an intimate knowledge of income-tax work which one cannot ordinarily expect a purely judicial officer to acquire even after a brief period of special training. The experiment may, however, be tried in a few instances if Government see no other difficulty in the way of doing so.

321. The proposal of removing the control of the Central Board of Revenue over Appellate Assistant Commissioners makes it necessary to find a different avenue of promotion for them. We think that the best course would be to provide that the normal avenue of promotion for Appellate Assistant Commissioners should be to the Appellate Tribunal. The Act as it now stands provides that the Appellate Tribunal must consist of an equal number of Judicial Members and Accountant Members. Sub-section (3) of section 5-A requires that the Judicial Member shall be a person who has exercised the powers of a District Judge or who possesses such qualifications as are normally required for appointment to the post of a District Judge; and the Accountant Member shall be a person who has for a period of not less than six years practised profession as a Registered Accountant enrolled on the Register of Accountants maintained by the Central Government under the Auditors Certificate Rules of 1932. The proviso to the sub-section, however, enables the Central Government to appoint as an Accountant Member any person not possessing the qualifications required by that sub-section, if it is satisfied that he has qualifications and has had adequate experience of a character which render him suitable for appointment to the Tribunal. In virtue of this proviso some members of the Department have been appointed as Accountant Members of the Tribunal and have held these posts with distinction. We doubt whether, on the pay at present offered to a Member of the Appellate Tribunal, especially as the appointment is for short terms, successful members of the legal and accountancy professions would come forward to accept these posts, and it would certainly, in our opinion, be inadvisable to recruit second rate men from the professions to man such posts. If men with requisite qualifications and experience from the legal and accountancy professions are not forthcoming in sufficient numbers, it would, in our opinion, be advisable to recruit members from the judicial and Income-tax Departments. The judicial experience of persons holding substantive posts in the Judicial Department would make them well qualified to hold the offices of Judicial Members, and we think that experience as an Appellate Assistant

Commissioner extending over a period of several years should enable Appellate Assistant Commissioners to perform satisfactorily the duties of Accountant Members of the Tribunal. The question of having technical qualifications in accountancy is not of prime importance in filling these posts, but there must be capacity in Accountant Members to examine the accounts. This an Appellate Assistant Commissioner must necessarily possess if he is to perform his duties satisfactorily, and it should enable him to discharge the duties of the Accountant Members of the Tribunal with efficiency. We do not suggest that members of the legal and accountancy professions should not be appointed to the Tribunal, but we think that once they are appointed, they should be expected to hold the post on a permanent basis and should not expect to revert to the profession after the expiry of their period of appointment. If, under these circumstances, it is not possible to recruit first rate men from the professions, we would much rather recruit to the Tribunal men who are already in service. We may also point out that we are recommending that in the recruitment of future Income-tax Officers emphasis may be laid on their possessing adequate accountancy qualifications, and we think that such persons, after experience as Income-tax Officers and Appellate Assistant Commissioners, would provide a suitable recruiting ground for promotions to the Tribunal. The appointments should be made by the Ministry of Law on the advice of the President of the Appellate Tribunal. If there are not likely to be sufficient places on the Appellate Tribunal to afford reasonable prospects of promotion to Appellate Assistant Commissioners we would recommend the creation of a few posts in the grade of Appellate Assistant Commissioners carrying a salary approximating to that of a Commissioner of Income-tax, so that some senior Appellate Assistant Commissioners may be appointed to them.

322. So far as the second point is concerned, in framing the question as we did, we were mainly impressed by the fact that there were two appeals on question of fact. Normally, in the civil judicature there is only one appeal on a question of fact, and the second appeal lies only on a point of law, and we desired to know whether such a procedure could not with advantage be adopted in income-tax matters. But the weight of opinion is definitely against the abolition of the second appeal on questions of fact. We recognise that income-tax proceedings are somewhat different from the proceedings before the Civil Courts. In the latter, the Judge is a person who is independent of parties, whereas in income-tax matters, the Income-tax Officer is a party, an investigator and a judge, all rolled into one. The analogy of Civil Courts, therefore, may not justly be pressed. The President of the Appellate Tribunal has also stated that under the proposal recommending direct appeal to the Tribunal in certain classes of cases, the Tribunal would be so flooded with appeals that it might be necessary to create many more Benches, with the result that several more Members will be necessary for the Tribunal. We do not, therefore, think it necessary to press at present this part of our proposal. We think that once the public are satisfied that Appellate Assistant Commissioners have been made independent of the Department, as suggested in our proposal, the number of second appeals on questions of fact would be considerably reduced.

FF.—Appellate Tribunal

323. So far as the Tribunal itself is concerned, some difficulties in its working have come to our notice. Under the present arrangements, the Tribunal functions through its Benches sitting at Calcutta, Madras, Bombay and Allahabad. The decisions of the various Benches are not reported and it is not inconceivable that on the same point of law or procedure two Benches of the

Tribunal may take different views, without being aware of the conflict. We, therefore, think it desirable that some adequate machinery should be devised—after consultation with the Tribunal—for the reporting of the decisions of the various Benches and also for conflicts, if any, in the decisions being resolved by a Full Bench of the Tribunal.

324. Further, any reference made by the Tribunal to the High Court has to go to the appropriate High Court, the precise forum being determined by the place where the original assessment has been made. It has accordingly happened that on the same point being referred to two different High Courts contradicotry decisions have sometimes been obtained For example, the Patna and Allahabad High Courts held in *Srimati Lakshmi Daiji vs. Commissioner of Income-tax, Bihar and Orissa* (1944 I.T.R. 309) and *Mst. Sarju Bai vs. Commissioner of Income-tax* (1947 I.T.R. 137) that interest on arrears of rent is not liable to tax as it is "rent or Revenue derived from land", while the Madras High Court and the Calcutta High Court have held in *Pethaperumal Chettiar vs. Commissioner of Income-tax* (I.L.R. 1944, Mad. 322) and in *Re Manager, Radhika Mohan Roy Estate* (A.I.R. 1941 Cal. 443) that it is taxable as it is not such rent or revenue ' The question has only now been finally decided by the Privy Council accepting the Madras and Calcutta view in *Commissioner of Income-tax, Bihar and Orissa vs. Kamakhya Narayan Singh*, P.C. App. No 26 of 1947—(1948 M.L.J.R 417). But until the question was settled, the Tribunal was bound by both sets of High Court decisions and had necessarily to decide the same point in two different ways—according as the case came from Bihar and United Provinces or from Madras and Bengal. We consider this position unsatisfactory. It was suggested at one time that all income-tax references should be heard by the Federal Court in order to ensure uniformity. On further consideration, we understand, the proposal was abandoned because the number of references made to the different High Courts was so large that the disposal of them by the Federal Court would have entailed enormous work on that Court and would have occupied a large part of its time. Now that the Federal Court has been invested with the powers of the Supreme Court to hear appeals from the High Courts, the proposal that it should hear all income-tax references becomes still less feasible. We think, however, that werever a conflict exists between the decision of two High Courts it should be within the power of the Tribunal to refer the point of law for the opinion of the Supreme Court—whose decision will, of course, be binding on all the High Courts For an analogy, we may refer to section 113, Code of Civil Procedure and Order 46 which empower any Court to state a case and refer it for the opinion of the High Court

325. We are further of the opinion that the Tribunal should have power to order costs to be paid in any appeal pending before them. Such a power is vested in the High Courts under sub-section (6) of section 66, and we see no reason why similar discretion should not be vested in the Tribunal. Such power would act as a wholesome check against frivolous appeals being filed before the Tribunal We further think that the Tribunal should also have discretion to order that the whole or part of the fees paid by the appellant assessee under sub section (3) of section 33 be refunded to the appellant depending upon degree of success which such appellant has obtained in his appeal.

326. As regards the deposit made by an assessee under section 66(1) in connection with his application for reference to the High Court, it will be noticed that the Act contains no provision authorising the High Courts to direct its return even if the assessee succeeds in his reference. It is perhaps possible to suggest that the provision in sub-section (6) of section 66 in respect of costs will include a direction for the refund of deposit also. We, however, understand that the practice in the High Courts in this matter is not uniform. It will be anomalous if a successful assessee should be awarded costs on the reference

but not a refund of the deposit. Whether the deposit be regarded as a check against frivolous applications or analogous to the Court fee paid on a memo. of appeal, the successful applicant seems justly entitled to a refund of the deposit. Sub-section (6) of section 66 may, therefore, include a specific provision for a direction for the refund of the deposit or part thereof in appropriate cases.

327 A suggestion has been made to us that the Appellate Tribunal should, in suitable cases, have power to enhance the assessment. It has been held that no such power exists at present in the Tribunal, although an Appellate Assistant Commissioner can enhance the assessment under section 31(3)(a) of the Act. We presume that the Legislature adopted this course because under the Act there is no provision made for an appeal by the Department against an Income-tax Officer's order, whereas the Commissioner can file an appeal against an Appellate Assistant Commissioner's order [section 33(2)]. Even if no appeal is filed, we understand that the practice of the Appellate Tribunal is, that so long as the total amount of assessment is not increased, the Department is allowed to support the Appellate Assistant Commissioner's order on grounds or in respect of items which have been *disallowed* by the Appellate Assistant Commissioner The only question, therefore, is whether the Appellate Tribunal should have power to vary in favour of the Department the order under appeal in respect of any item disallowed by the Appellate Assistant Commissioner even if the Department has not chosen to appeal against the Appellate Assistant Commissioner's order. We do not think it necessary to give such a wide power. It is, however, conceivable that Government may not choose to appeal against some portion of the Appellate Assistant Commissioner's order so long as the assessee was prepared to acquiesce in the order as a whole On the analogy of the provisions of the Civil Procedure Code relating to the filing of a memorandum of objections by a respondent, we suggest that such cases may be met by enabling Government to file a memorandum of objections against so much of the order as is against Government provided it is filed within 30 days of the service upon them of the notice referred to in Rule 20 of the Appellate Tribunal Rules, of the appeal having been filed by the assessee

328. Sub-section (1) of section 66 lays down that the Appellate Tribunal, shall on an application being made to refer any question of law to the High Court, refer it within 90 days of the receipt of such application. It has recently been held by the Madras High Court in *Commissioner of Income-tax, Madras* vs. *O.R.M.S.S. Sevugan* (1948 I.T.R. 59) that the High Court can examine the propriety, correctness and legality of the reference and where, for example, it finds that the reference should not have been made, it can refrain from expressing an opinion. If, therefore, there is delay of more than 90 days in making the reference, it may conceivably be rejected. This may result in hardship to the party asking for a reference as a consequence of a default for which the party is in no sense responsible. We, therefore, recommend that the provision prescribing 90 days' limit for making a reference to the High Court be deleted A public body like the Appellate Tribunal may be trusted to make the reference as soon as practicable.

329. Sub-section 7A of section 66 applies the provisions of section 5 of the Limitation Act to an application to the High Court by an assessee under sub-sections (2) and (3) of that section. Those provisions have the effect of extending the period of limitation where there is sufficient cause for not presenting the application within time. In our opinion the section requires to be amended in two respects. Under sub-sections (2) and (3) an application can be made by the Commissioner as well as by an assessee and we see no reason why the concession given by section 5 of the Limitation Act should not be made available to the Commissioner also. It is not inconceivable that owing to departmental procedure and circumstances beyond the control of the Commissioner

such as postal difficulties, applications for reference may get delayed and as a consequence they may run the risk of being dismissed summarily. Secondly, section 5 of the Limitation Act is made applicable only to applications made to the High Court. There is no provision for extending, for just and sufficient cause, the period prescribed in sub-section (1) for making an application to the Tribunal praying for a reference to the High Court. Just as the Tribunal can under sub-section 2A of section 33 admit an appeal after the expiry of the period of limitation, where it is satisfied that there was sufficient cause for its not being presented within that period, we consider that it should have similar discretion in admitting applications for a reference to the High Court after the period of 60 days mentioned in sub-section (1) of section 66 has expired. We therefore, recommend that sub-section 7A of section 66 be amended by the insertion of the words "or the Commissioner under sub-section (1)" and the omission of the word "under".

GG.—Miscellaneous Recommendations

330. We may now deal with a few suggestions which were not included in the Questionnaire either because they related to verbal amendments not involving any question of principle or because they were received after our Questionnaire had been issued.

331. *Section* 2(11) —The definition of the words "previous year" in relation to a new business requires clarification, so that in certain contingencies profits made during certain months may not escape assessment. If a new business is started on 1st July 1945, it is started in the financial year 1945-46. Under clause (c) of the definition, it is open to the owner of such business to say that for the assessment year 1946-47 his accounts are made up as on 30th June 1946 That date does not fall between 1st July 1945 (when the business started) and 31st March 1946; accordingly, under the proviso there is no "previous year" for him for the assessment year 1946-47. For the assessment year 1947-48, clause (c) would not apply, as the business was set up *before* and not in the financial year (1946-47) preceding the assessment year. Therefore, clause (a) will apply and the assessee may ask to be assessed on profits from 1st April 1946 to 31st March 1947, with the result that profits from 1st July 1945 (when the business started) to 1st April 1946 will escape assessment. Proviso to clause (a) would not help, as till then he had never been assessed It is, therefore, necessary to link up the option under clause (c) with the option under clause (a) The option under clause (c) should be exercisable within 12 months of setting up the business. To give effect to these suggestions, the following amendments are recommended:—

(i) in the proviso to clause (a) of section 2 (11), after the words "income profits and gains", insert the words "or has exercised option under clause (c)", and

(ii) in clause (c) of section 2 (11), after the words "at the option of the assessee" insert the words "which shall be exercised within twelve months of setting up the business".

332. *Section* 4(1) (*b*).—In view of the decision of the Allahabad High Court in *Govind Ram Tansukh Rai's* case (1944 I.T.R. p. 450), it has been suggested that an amendment should be introduced in section 4 (1) (b) to get over the result of that decision. That judgment—which has been recently followed in *Commissioner of Income-tax, Bihar and Orissa* vs. *Ramachandra Keshavdeo* (1948 I.T.R. 150)—dealt with the assessment of remittances from without British India made during the pendancy and in the course of the accounting year. The Income-tax authorities sought to assess them as profits of that year, but the court held that as profits could be deemed to have been made only when the accounts are made up at the end of the year, any remittance during the course of the year could not be held to have been made "out of profits". It is pointed out that this may lead to the following anomaly:

that in the accounting year such remittance would not be taxable because it was not 'profits' of that year and in the succeeding year it may not be taxable because the remittance could not be held to have been made in that year, as it has in fact been made in the earlier year. This problem may arise either with reference to remittances from the Indian States or from places outside India. If our suggestions about treating profits made in the Indian States as on the same footing for purposes of Indian Income-tax assessment as profit made in the Indian Provinces are accepted, the problem will lose much of its importance But even so cases are still conceivable where the problem may arise. We think provision to the following effect may therefore be added in explanation after explanation (1) to section 4(1):—

'Where remittances are made to, or received in, the Indian Union by a person earning income outside the Union and it is ascertained when the accounts are made up in respect of the year during which the remittance was made that such person earned a profit in the business carried on by him outside the Union, such remittances may to the extent to which they could have been sent out of the ascertained profits be presumed to have been remitted out of such profits."

In Explanation 2 to section 4 (1), the words 'and not being pension payable without India' may be omitted as there is no longer any need or justification for that exemption.

333. Section 4-A (b).—It will be noticed that sub-sections (a) and (c) of section 4-A attempt to define "residence" with reference to each year by the use of the expression "in any year", but these words are not repeated in sub-section (b) which relates to Hindu Undivided Family, firm or other association of persons A possible suggestion is that the omission was intentional apparently on the assumption that the place of management and control of the affairs of a Hindu undivided family is not likely to change from year to year. But the sub-section applies not merely to Hindu undivided families but also to firms and other associations and there is no more reason to assume a permanence of place of management in their case than in the case of companies which are provided for in sub-section (c). This rather leads us to think that the omission of the words "in any year" from clause (b) was due to inadvertence. Anyhow, the repetition of those words in that sub-section will not do any harm, because if the place of management does not change, no legal consequence will arise therefrom. If, on the other hand, the place of management changes from time to time, there may be difficulty in applying the sub-section as it stands. We, therefore, think it safer to insert the expression "in any year" in sub-section (b) also. As this insertion will require the sub-section to be worded somewhat differently, it may run as follows:—

"A Hindu undivided family, firm or other association of persons is resident in British India in any year in which the control and management of its affairs is not situated wholly without British India."

334. In cases in which residence has to be determined not with reference to the physical presence of an individual but with reference to control over business, a further problem may arise, particularly in the case of unregistered firms and associations and possibly even in the case of joint families Section 2 (11) allows different periods to be reckoned as "previous year" for separate sources of income of an assessee. Similarly, businesses may be so controlled **and managed in respect of different parts thereof** that persons interested in them may be "resident" in respect of one business and "non-resident" in respect of another. In a case before the Madras High Court,—*Commissioner*

of Income-tax. Madras vs. V.E.K.R. Savumiamurthy (1946 I.T.R. 186) similar question arose, though under somewhat different circumstances. The learned Judges, in discussing the validity of the argument presented to them, made the following observation:—

> "In respect of each separate source of income the year of account is to be ascertained and if it is found on applying the provisions of sections 4-A and 4-B with reference to that year that the assessee was "resident" or "not resident" or "not ordinarily resident' in British India as the case may be, the income of that year is to be computed on the appropriate basis indicated and the total income of the amounts thus computed for all the sources of income, whether British, Indian or foreign, is to be charged to tax.........It is possible in such cases that he should be assessed as resident in respect of some of the sources and non-residen in respect of others."

The learned Judges recognised that this may be a cumbrous procedure, but on the language of the Act as it stood they though that "an assessee may in conceivable cases have to be dealt with as resident and non-resident in respect of his different sources of income". This is to say the least a very anomalous position. Principle or expediency may demand that internal income and external income must be assessed on different principles, but it will be a curious position to treat an assessee as resident for some purposes and non-resident for certain other purposes. It seems to us, therefore, desirable to add a provision in the context of sections 4-A and 4-B to the following effect:—

> "A person shall be deemed to be resident in British India for all purposes of the Act if he or it is resident in British India in the previous year in respect of any source of income, notwithstanding that he or it is not resident in British India in the previous year or years in respect of any other source or sources of income."

So far as the residents of Indian States are concerned, a provision like the above will only mean another way of giving effect to the recommendation that we have already made that residents of Indian States who have a source of income in the Indian Union should be treated as residents of the Union. Such a provision may perhaps involve repercussions on the question of the residence of Companies, when applying the second part of section 4-A (c). As we are not in a position to say whether and how far our recommendations or the other suggestions, we have noticed when dealing with section 4-A(c), are likely to be accepted, we merely invite attention to this aspect of the question, so that the Government may appropriately provide for it in consonance with such line as they may adopt in regard to section 4-A(c).

335. Section 9.—A suggestion has been made to us that depreciation should be allowed on house property at least when it is habitually let out at rent and the income from which is assessed under section 9 of the Indian Income-tax Act. This proposal is based on the argument that a similar property, when it is used for his own business by the owner becomes entitled to depreciation allowance under section 10 (2)(vi) of the Indian Income-tax Act.

336. Under section 10 of the Indian Income-tax Act, a building which is used for the purposes of the business is entitled to both cost of current repairs under section 10 (2) (v) and to depreciation under section 10 (2) (vi), while under section 9 (1) (i) only a sum equal to one sixth of the *bona fide* annual letting value of the property is allowed for repairs. It would not be perhaps correct to hold that this latter allowance is large enough to cover replacement value of the house property over the years of its use and also the cost of current repairs during the same period Ordinary, it used to be said before the war, that in the principal cities where the rents were high, one month's

rent or 8⅓ per cent. of the rental value would cover current repairs on the average, because although in the first few years after construction the expenditure on repairs will be small, it will increase as the property grows older. On the other hand, it has also been said that at least since the war, with the rise in building costs as well as of fittings and the low level of rental receipts in places outside the principal cities in India, the cost of current repairs is at least equal to, if not higher, after the first 12 or 13 years, than the allowance given under section 9 of the Act. For the purpose of the argument, therefore, it may be presumed that the repairs allowance cannot be treated as including an element of depreciation allowance.

337. By the combined operation of sections 10(2)(v) and 10 (2)(vi), the owner of a property who uses it for his own business gets not only allowance for current repairs, when he incurs them, but also the cost of a Sinking Fund which would replace the value of the property in about 40 or 50 years and even less. While the same owner, if he lets out the same property to another also for being used for the purposes of business, gets no allowance for depletion of his capital on the property, which, in about 80 to 100 years at the most, will have no sale value. This is claimed to be an unfair distinction without a difference. Mr A. C. S. Iyengar argues that "logic and stern realities require that the same depreciation should be allowed, at any rate, in respect of such buildings as are intended to and are habitually let out by the owner and are used as income producing property". The claim for depreciation is, in effect, a claim for replacement of depleted capital. In discussing such claims, the Royal Commission on Income-tax (1920) said:

"For income-tax purposes, speaking in general terms, income is the surplus of receipts over the current expenditure necessary to earn those receipts regardless of the appropriation of any part of the receipts or surplus for the purpose of writing off or amortising the capital value of any assets that waste in the process of producing the income. The primary reason for this exceptional treatment of plant and machinery appears to be that an allowance for the wastage of this particular asset is merely equivalent to that allowance for renewals and replacements of tools and implements used for the purposes of a trade which has from the first been recognised as necessary under the Income-tax Acts"—(paragraph 180 of the Report). Developing the argument further, the Commission said: "If in assessing an income, we are to take into consideration in every individual instance the wastage of the source of the income, then it will be impossible for us to ignore the human element in income production..............The varying circumstances and the unequal duration of the profit earning lives of human beings make it impossible to devise any practical method of giving to all classes of income an allowance equivalent to the depreciation allowance we have been asked to give to the possessor of any and every inherently wasting asset. We think that in that practical world which alone can be considered for the purposes of taxation, the income which represents the taxable faculty is not a mathematical abstraction but that net receipt which in the hands of its possessor is usually regarded as income, that is to say, as a receipt out of which current expenditure may be met, subject possibly to some general saving, but not either in theory or practice subject to any specific appropriation for the replacement of the capital which is used in earning the income and which over a long period of years may waste in such use".

338. The Commission found it impossible, therefore, to make any general recommendation on the subject. Their recommendation in paragraph 200 of the Report reads as under:

"Subject always to the limitation that their lives fall short of 35 years, we recommend that an allowance shall be given in respect of all inherently wasting material assets which have been created by the expenditure of capital

such as buildings and foundations, surface works, permanent way and equipment of Railways and Tramways, docks and shaft sinkings and other initial work and development". Even this recommendation will be inapplicable to the question under discussion, as buildings have a longer life than 35 years. The decisions of the Courts in England are equally unhelpful to the proposal made. In discussing a similar claim, but in respect of capital invested in buying an annuity, the Lord President, in *Coltness Iron Co.* vs. *Black* (1887—C AC 315), says:

"Nor does it make any difference on the incidence of the tax that the income has been created by the sinking of capital as in the case of the purchase of annuities, instead of being merely the natural annual product of an invested sum, which remains unconsumed and undiminished by the consumption of the income it yields.........When he purchases an annuity he converts his whole estate into an income which represents no capital but that he has paid away or exhausted to purchase the income. But the statute takes no heed of his exhausted capital, and makes no deduction from the actual amount of his income on that account."

339. In view of the considerations above adduced and the possible results of applying a different principle to cases like taxation of income from mines, brickfields, etc., we are not able to accede to the suggestion merely on the ground of analogy.

340. *Section 10 (2) (vii).*—This section must, we think be intended to be of the same scope as section 12 (3) (iii) and we see no reason for the omission of the word "furniture" from section 10 (2) (vii). We are inclined to think that the omission is merely due to inadvertence. We, therefore, recommend that the words "or furniture" be inserted after "plant" in section 10 (2) (vii).

341. *Section 10 (2) (x).*—Section 10 (2) (x) allows "any sum paid to an employee as bonus or commission for services rendered" as a permissible deduction, if certain conditions are satisfied. It has been recognised that the object of the limiting words was to prevent an escape from taxation by decribing a payment as bonus or commission when in fact it should have reached the payee as profit or dividend. In the practical application of this section, two cases of difficulty may arise: (i) when bonus is paid to employees *some* only of whom may also be shareholders, (ii) when the bonus paid to such shareholder-employees may be excessive in the light of the tests suggested in clauses (a), (b) and (c) of the proviso.

342. A question arose before the Bombay High Court in *Loyal Motor Services Company, Ltd.*, vs. *Commissioner of Income-tax* (1946 I.T.R. 647) with reference to the application of this section to a case where the Commissioner contended that the amount of bonus paid to certain employees, who were, also shareholders in the company, should be disallowed. It was found as a fact in the case that bonuses though of smaller amounts had been paid to other employees also and, after some objection, the Department had recognised this part of the bonus as an admissible deduction. But so far as the shareholder-employees were concerned, the point was stressed that it must be deemed to have gone to them in their capacity as shareholders and not in their capacity as employees, especially as the rate at which the bonus had been paid to them was much higher than the rate adopted in the case of the other employees. On the question of rate, however, it was pointed out that the shareholder-employees were paid at a higher rate because their salary was higher than that of the other employees and the bonus was fixed at so many months' salary. The way the question seems to have been argued and considered was, on the one side, that the *whole* sum paid as bonus to all the employees should either be allowed or disallowed and, on the other side, that it was open to the court to split it up and allow a portion thereof as a permissible deduction. It will be noticed that clause (x) opens with the words "any

sum" and in the middle of the clause occur the words "*such* sum". The learned Judges held that the expression "any sum" and the expression "such sum" should have the same connotation and the latter could not be read as meaning such sum *or part thereof*. We do not think it necessary to say anything as to whether the other construction was possible or not, on the language as it stands. But it seems to us that it may lead to unexpected consequences or unnecessary hardship, if in the matter of permitting bonuses to be treated as legitimate deductions, the authorities should be limited to only one of two courses, either to recognise the total amount of bonus paid as a permissible deduction or to disallow the whole. As already indicated, this question between the whole and the part may arise either with reference to cases where it may be regarded as legitimate in respect of some employees and unjustifiable in the case of other employees, or the amount paid in some cases be regarded as excessive and the department may be prepared to recognise a part of the amount as a legitimate payment by way of bonus or commission but not the whole. The language of the three clauses of the proviso which prescribes the tests to be applied in the determination of this question seems to suggest the possibility that the payment may be upheld in part. If, however, the enacting words of the clause do not permit of the splitting up of the bonus or commission and upholding a part as a legitimate deduction, the proviso cannot be held to add to the enacting words. We would, therefore, recommend that the language of clause (x) may be so modified as to enable the Department to allow the whole or part of the bonus or commission as a legitimate deduction in either or both of the categories of cases above described. It has been pointed out that the reference to "commission" in this sub-clause may sometimes give rise to doubts as to whether cases in which a person is remunerated in whole or in part by commission should be dealt with under this sub-clause or under sub clause (xv), which will be the appropriate clause if he was remunerated by a salary The question as to which clause is applicable becomes material, because the discretion under sub-clause (x) is more rigorously limited by the provisos than the discretion relating to the application of sub-clause (xv) If, as has been generally assumed the object of sub-clause (x) was to prevent partners of firms and dominant shareholders in private companies from paying themselves profits or dividends under the guise of commission, the general application of sub-clause (x) to all cases in which an employee may happen to be remunerated by a commission (though he may not be a partner or shareholder) will be extending the object of that sub-clause It is not clear whether there was any special object in using the words "bonus" and "commission" in juxtaposition. It may be desirable to give a clearer indication as to whether cases of employees being regularly remunerated on a commission basis are expected to be dealt with under sub-clause (x) or sub-clause (xv).

343. *Section 24.*—Section 24 (2) provides for the carrying forward of losses where it is not possible to adjust them against the profits or gains of the year in which they were incurred. The general principle followed in giving effect to this provision is that the carrying forward is permitted only to the person who himself sustains the losses. It was a problem whether his heir-at-law should not also have the same privilege. The Bill as originally introduced in 1938 provided for the carrying forward but did not extend this privilege to the heir-at-law. It was only during the passage of the Bill in the Legislature that an amendment was agreed to in favour of the heir-at-law enjoying this privilege; and it seems to have been considered sufficient to introduce this privilege by inserting the words "otherwise than by inheritance" in proviso (e) to sub-section (2) of section 24. The object of the amendment was stated to be "that when an individual dies the carrying forward of losses should not

die with him but it ought to be carried over in the hands of the son and he must be entitled to set off the losses against the profits that may accrue". We are not, however, sure whether this is the right form in which to give effect to the intention of the amendment. In its present place, this expression only occurs "as an exception to a restrictive proviso". Strictly construed, the exception will merely exclude the operation of the proviso *pro tanto*. The privilege itself must be founded on the enacting words of the main clause. It will be difficult to find words in sub-section (2) of section 24 as it now stands to confer any such privilege. We think the appropriate course will be to insert the words "or his heir-at-law" between the words "if any, of the assessee" and "from the same business, profession or vocation" in sub-section (2) itself

344. *Sections 25 (3) and 25 (4)*.—It has been represented to us that sections 25 (3) and 25(4) of the Indian Income-tax Act have been used for avoidance of tax very freely and that both on this score and on account of the fact that the rates of taxation as obtaining now are much in excess of the rates of tax obtaining under the Act of 1918 undue advantage is being taken by persons who claim the benefit of these provisions. A brief history of the circumstances that led to their enactment will be necessary to elucidate the position

345 Under the Act of 1886, assessment was made each year on the statutory income of the year which was practically the income of the previous year. Under section, 33 of that Act, if a person ceased "to carry on the trade or business in respect whereof the assessment was made or if such person dies or becomes insolvent before the end of the year for which the assessment was made or if any such Company or person is, from any other specific cause, deprived of or loses the income on which the assessment was made", the Collector on proof "to his satisfaction of any cause as aforesaid shall amend the assessment as the case may require and refund such sum if any as has been overpaid". The Income-tax Act of 1918 introduced a substantial change in the method of assessment. According to the new method, provisionally tax was levied on the income of the previous year, and was subsequently adjusted by substituting for the previous year's income the income actually earned in the assessment year. The last income to suffer an assessment under the old Act was the income earned in 1916 17 which was assessed for the assessment year 1917-18. The assessment for 1918 19, although at first provisionally made on the income of 1917-18, was finally made on the income of 1918-19, with the result that the income of 1917-18 neither suffered tax for 1917-18 nor for 1918-19 and escaped tax altogether Thus, "a business opened in 1914-15, for instance, would up to and including 1919-20, have been assessed finally only five times on six years' working. When, therefore, the adjustment system was abandoned on the passing of the Act of 1922, it was agreed that one final adjustment should be made in the year 1922-23 and both a final assessment or adjustment under the old system (retained for one year by section 68, 2nd proviso of the Act of 1922) and an assessment under the new system were made on the income of the year 1921-22. The assessment under the new Act in the year 1922-23 was made for the year 1922-23" . . . . (Sundaram's Law of Income-tax, pages 887-8).

346. In view of the 'double assessment' effected in 1922-23, the Act of 1922 introduced a provision under section 25(3) enabling a person who discontinued a business, profession or vocation, which was at any time assessed under the Act of 1918 to claim that he shall not be assessed at all on the income of the period between the date on which he closed down his business and the end of the preceding previous year, or he could claim that the income of that period shall be substituted for the income of the preceding previous year and be assessed as such. But in making that provision, the previous

history of the assessments in 1918-19 appears to have been lost sight of. It has even been suggested by Khan Bahadur Vachha that this was probably done by design and not merely by oversight. The justification for the provision under section 25(3) has been explained by Mr Sundaram in his 'Law of Income-tax in India' at page 889 as under:—

"So far as persons assessed at any time under the Act of 1918 are concerned, the double assessment in 1922-23 brought the assessment abreast of the income as already explained. At the end of any year such a person has been assessed for precisely the same number of years as his business has been running. If, therefore, he were assessed in the year after closing down on the income of the last working year, he will be assessed for one year in excess But in the case of a business taxed for the first time under the Act of 1922 the tax collected is lagging a year behind because in the Act of 1922 there is no provision for assessment on estimate in the year in which a business is opened as there was under the previous Acts. Consequently, unless an assessment was made in the year after closing down on the income of the last year's working, the number of assessments would be one short". In the case of persons whose income was derived from salaries and other sources taxed at source, assessments kept pace with their income on account of the taxation at source to which they were subjected from the very first. Therefore, section 25(3) made no reference to salaries, etc. The concession under section 25(3), as it stood prior to 1941, applied equally to income-tax and super-tax. Super-tax was introduced in the year 1917-18. It was not at first liable to adjustment, but the adjustment system was applied to it in 1920-21. Again, to quote Mr. Sundaram (page 888 of his book 'The Law of Income-tax in India'): "Ultimately, the income of one year, namely, 1919-20 was taken as the basis for a final assessment to Super-tax owing to the adjustment system. A provisional assessment was made on it in 1920-21 and in 1921-22 a final assessment was made by adjustment with reference to the income of the year 1920-21. The tax was thus shifted, forward from the income of the year 1919-20 to the income of the year 1920-21. In effect, therefore. Super-tax had always been levied on the previous year's income and consequently assessment to Super-tax stood in this matter on a different level from that for Income-tax." This difference between the positions for Income-tax and for Super-tax was noticed later and by a proviso introduced by the amending Act of 1941 below sub-section (4) to section 25, sub sections (3) and (4) of that section were made inapplicable to Super-tax.

347. By the amending Act of 1939, sub-section (4) of section 25 was introduced by which the benefit described in section 25(3) was made applicable also to succession as distinguished from discontinuance, provided such succession did not mean merely a change in the constitution of a partnership.

348 Khan Bahadur Vachha has invited our attention pointedly to this change, which he thinks is being widely used to perpetuate "a fraud on revenue". He says· "Whenever an assessee has a highly profitable year, he resorts to some trick to show that the business has been either closed down or succeeded to and pays no tax on the enormous profits earned. Very often he actually closes down the business or converts a proprietary concern into a Company, a Hindu undivided family into a firm or partnership, etc., as so much tax can be saved thereby". There can also be no comparison ', he says, "with the profits which a newly started business in 1918-19 or thereafter was earning in 1921-22 and which it earns now after being built up for over 25 years. Further, the relief granted is ridiculous and fantastic, as the rates of tax in 1921-22 were

far far lower than the present rates. . . . . . Now after 25 years, if the business does still exist, the difference in earning power is certainly enormous and rates of tax applicable may be ten times as high. These sections 25(3) and 25(4) have now served out their honest purpose, if there was any, and should have no further place in the Income-tax Act".

349. We recognise that there is considerable force in this view, but it is equally important to remember that the provision under section 25(3) has been in operation for the last 26 years and that during this long period, a number of businesses must have changed hands. Under section 26 of the Income-tax Act, as it stood prior to its amendment in 1939, the successor to a business was taxed on the profits that his predecessor earned and it cannot be denied that one of the considerations on which the successor would have accepted this liability would have been the possibility of the tax concession he might ultimately secure under section 25(3) of the Act. To cancel the latter provision therefore, would be a breach of faith on the part of Government and might do injury to many genuine investors. On the other hand, by extending the provision to cases of succession by a third party, the temptation to avoid tax liability has been increased. This temptation will vary with the incidence of the tax. We agree on the whole that the tax concessions under sections 25(3) and 25(4) have now practically outlived their purpose with the March of Time and that they might now be withdrawn, after providing for such a tax concession as might absolve Government from a charge of breach of faith.

350. Three suggestions have been made to us: The first is that as the income of 1917-18 has escaped tax altogether, the provisions under sections 25(3) and 25(4) should be deleted without any countervailing concession. We are not prepared to go so far. The Legislature evidently over-looked this aspect of the case and it is too late to dig it up now. The second proposal is that the assessee should be reimbursed only to the extent of the tax actually paid on the income last assessed under the Act of 1918 in respect of the business discontinued or transferred. This proposal also, we think, would be inequitable as the money value has changed considerably since 1921 and transfers may have been effected in between the years 1921 and 1938. The third proposal seems more equitable. It is proposed that provisions under sections 25(3) and 25(4) regarding the exemption from tax of the last bit of income and the substitution alternative should be abolished but that in arriving at the amount of tax to be demanded, the assessee should be given credit for the tax on the assessable income of the relevant period, at the rate that would have been applicable to that income under the Finance Act of 1938-39. This proposal has the advantage that it would remove the temptation to an evader to take advantage of higher rates of tax; as the profits, likely to accrue in the years to follow, may not be very different from what they were prior to the war, the difference in this respect is also not likely to be large. We would recommend that this suggestion be adopted.

351. *Section 25A.*—Section 25A provides a procedure for the assessment of the income of a joint Hindu family, earned during the time when it was joint but assessed only after its disruption. In the case of a joint family, proceedings under section 34 to assess or re-assess escaped income may happen to be taken many years after the disruption of the joint family and even after the Income-tax Officer had recognised the division under section 25A(1). It is doubtful if such a case will be covered by section 25A. It will be desirable to make express provision for such a case specifying the persons to whom notices should be given and the steps that may be taken to recover the tax that may be assessed.

352. In the application of section 34 to a disrupted joint family, a further problem may arise, as to the officer entitled to initiate proceedings. It may happen that the *quandom* members of the joint family are living or carrying on business in different localities after the division. The residence of the *karta* in such a case will be of no consequence. Some Income-tax Officer has

under the law to be satisfied that there has been an escape of assessment before proceedings under section 34 can be initiated. It seems to us necessary to make express provision for such a case, because in the new state of things, the persons concerned may no longer be living within the same local jurisdiction as the original joint family or its *karta*.

353. *Sections 31 and 33.*—We think there is some force in the suggestion that sections 31 and 33 must make provision for restoration of an appeal which has been heard or dismissed in the absence of an assessee. So far as section 31 is concerned, we doubt if it contemplates a dismissal for default in the absence of the assessee. Anyhow, we presume that the Appellate Assistant Commissioner is not bound to dismiss the case for default but may purport to dispose of it on the merits as best as he can. Before the Appellate Tribunal, it is provided by the rules (rules 24 and 25) that the appeal may be dismissed for default if the appellant does not appear when the appeal is called on for hearing and the Tribunal may hear the appeal *ex parte* if the appellant appears and the respondent does not appear. In none of these contingencies is a provision made for the matter being restored or reopened even if the assessee is able to show justifying cause for his non-appearance. In this respect, the position must at least be brought on a par with section 27 which contemplates and provides for cases where the assessee may be prevented by sufficient cause.

354. *Section 36* provides for taxes and refunds being calculated to the nearest anna. It has been suggested that under present-day conditions, it may be sufficient to make the calculation to the nearest rupee, ignoring fractions of a rupee less than eight annas and regarding fractions of a rupee equal to or exceeding eight annas as one rupee. This suggestion may be favourably considered if it is likely to save trouble to the office in working out calculations.

355. *Section 45.*—Section 45 which defines the circumstances in which an assessee becomes a "defaulter" is of importance not merely because the right to take proceedings under section 46 for recovery of the tax accrues on the default, but also because such default empowers the authorities to impose a penalty on the assessee. From this point of view, it seems to us right that the period allowed to the assessee for payment should be at least a statutory minimum and not be merely left to the whims of the individual Income-tax Officer. We have reason to think that in assessments made towards the end of the financial year there is a strong temptation—if not a regular practice—to make the period very short. Section 29 itself does not make any reference to the period to be allowed for payment, but from the several alternatives specified in section 45, it is obvious that the legislature contemplated that a month will be a reasonable minimum period. We would, therefore, recommend that either in section 29 or in section 45 it should be provided that the time allowed for payment should be not less than a month.

356. *Section 50.*—The 2nd proviso to section 50 confers power on the Commissioner and Assistant Commissioner (if specially empowered) to excuse the delay in applying for refund under section 49 if sufficient cause is shown; but the proviso limits the power to claims for refund of tax paid prior to 1939. We think that as a matter of general principle the power to excuse delay must be available in *all* cases, provided of course that sufficient cause is shown for not making the claim within the period prescribed.

HH.—Administration

(Question 54)

Recruitment of Income-tax Officers

357. "A haphazardly run office", says an American writer on Public Finance, "can no more be successful in its operations than a carelessly conducted business enterprise. If evasion is not to be widespread and if the taxpayer's money is not to be wasted in inefficient tax assessment and collection, a

technique of tax administration must be developed"—(Schultz, page 327). This view appears to be widely held in India also, to judge from the replies we have received to our Questionnaire The Income-tax Officer and the system of which he is the product are held, in these replies, responsible for driving the tax-payer first to non-co-operation, then to hostility and thirdly to evasion Incivility, incompetence, extortion and lethargy are some of the accusations made against the Income-tax Officer, while the administration as a whole is condemned as wooden, ill-managed, unimaginative and unjust The criticism embraces all aspects of the administrative system—the method of recruitment, the pay and prospects of the Income-tax Officers, (as they have [illegible] on the quality of the material selected), the present scope and period of t[illegible]f Officers, the arrangement of work in the Income-tax Offices the method and manner in which Income-tax Officers exercise their discretion and their powers, and the attitude of the Officers of the Department towards the public. Even after making due allowance for exaggeration of language, it is evident from the replies that a strong feeling of distrust and discontent exists in the public mind against the administration of Income-tax in this country. So long as that feeling persists, various types and forms of evasion are likely to thrive. We have, therefore, thought it necessary to examine the different aspects of administration in some detail We have carefully considered the many suggestions made to us both in writing and during interviews; we consulted the Federation of Gazetted Officers of the Income-tax Department and two other allied associations; we were anxious to have the views of the Central Board of Revenue; but, the period of our deliberations evidently coincided with a particularly heavy spell of work in the Board's office and we were unable to obtain the benefit of their comments and advice

358 Income-tax was introduced in India in the 19th century by Act XXXII of 1860. It was administered through the Provincial machinery for revenue, until the Income-tax Act, 1922, created a separate administration for the performance of duties under that Act. Even prior to 1922 in some Provinces notably in Bombay City and in Calcutta, Income-tax was administered through a distinct department under a Collector of Income-tax, who functioned however as a branch of and under the control of, the local revenue administration As the Income-tax Administration thus grew out of the provincial revenue machinery, the first recruitment under the 1922 Act was mainly from such revenue personnel, as had been associated with the assessment and collection of Income-tax in each Province The pay and conditions of service were modelled also on the local revenue administration in each Province Therefore, the scales of pay received by Income-tax Offiers in the different provinces were not uniform nor was the method of recruitment In some Provinces, the first batch of Income-tax Officers was drawn from the Provincial Deputy Collectors In places like Bombay, where a nucleus of Income-tax staff existed, it was strengthened in the various grades *e.g.* Income-tax Officers, Examiners, Inspectors, etc. by promoting revenue officials eligible for appointment to those grades on the strength of their experience or service. Except the Income-tax Officers the rest were non-gazetted officers, who helped the Income-tax Officers either in examining accounts produced by the assessees or in making outside inquiries about the sources and the amounts of income earned by them. In the mofussil areas, the scales of pay of the non-gazetted executive subordinates were similar to those of Provincial Tahsildars or Mamlatdars; but in the cities of Bombay and Calcutta, the pay of the posts was higher. Direct recruitment in the two major Provinces of Bombay and Bengal was first made to the grades of Examiners, Inspectors or Assistant Income-tax Officer and not as Income-tax Officers, presumably because the assessment work in the two cities of Bombay and Calcutta being of a specially complicated nature, previous long training was considered essential. The pay of these posts of Examiners and Inspectors was fairly high,

being Rs. 225—500. The Commissioners were, therefore, able to get men with high academic qualifications, *e.g.*, B.A., F.S.A.A., Barrister-at-Law, and Law or Commerce Graduates of both Indian and British Universities to fill these posts in these Provinces. In other Provinces, particularly in the U.P., recruitment was made by the Commissioner of Income-tax from among young men with high academic qualifications direct to the cadre of Income-tax Officers. This difference in recruitment according to which persons with similar qualifications started in one Province in the non-gazetted grade while in another Province, they directly entered the gazetted ranks has introduced various inequalities to which we shall revert later.

359. Although under the Act of 1922, the Income-tax Department came under the direct control of the Central Board of Revenue functioning as a Branch of the Finance Department of the Government of India, not only the recruitment of Income-tax Officers but also the appointments of Assistant Commissioners continued to be made on a provincial basis. These appointpointments were made by the Commissioners of Income-tax whose powers in respect of such recruitment were unrestricted, except for the nominal approval of the local Government, which acted in this matter as agent of the Government of India. Consequently, there was no interchange of officers from one Province to another, whether in the grade of Income-tax Officers or in the grade of Assistant Commissioners; even in the case of Commissioners, such provincial transfers were very rare. Gradually, the Central Board of Revenue introduced measures to bring in uniformity of pay, prospects and conditions of service among the different branches of the administration and this movement gained momentum, particularly after the Ayers Committee Report of 1936. Income-tax Service is now an All India or Central Service with uniform scales of pay for the different constituent cadres. In 1945, Mr. K. R. K. Menon, the then Director of Inspection under the Central Board of Revenue was deputed by the Board to reorganise the Department and the Department as it is now working is trying to work up to the scheme which he formulated after considering the normal annual output expected from the Department and the arrears of work accumulated at the date of his inquiry. The standards of work on which his proposals were made have virtually been accepted by Government. One fact which Mr Menon's inquiry brought out prominently was that the Department has been under-staffed heavily in all ranks, particularly in the rank of Income-tax Officers. The deficiency was perhaps the greatest in heavy charges like Bombay. To meet the deficiency, a few selections were made to Class I Service, through the Federal Public Service Commission, and, in addition, special recruitment was made to Grade III of nearly 200 officers who are now under training. Even so, the arrears have been accumulating.

360. **Cadre of Income-tax Officers.**—This Cadre is at present divided into three Grades—

Class I, Grade I,

Class I, Grade II and

Class II, Grade III.

Officers in Class I, Grade II, are either directly recruited on the results of the F.P.S.C. Examination for All-India Services or are promoted from Grade III, in the proportion of 80:20 for future vacancies. The direct recruits and those promoted, unless the latter have already acquired the qualification, have to appear for a departmental test and to undergo training before they can be confirmed. Appointments to Class I, Grade I, are made by promotion from Grade II except where Grade III Officers are directly promoted on the strength of their efficiency and past record. Appointments to Grade III are usually made from the subordinate non-gazetted ranks. Every Income-tax

Officer, to whatever grade he belongs, has to pass the departmental examination, which is identical for both the gazetted and non-gazetted ranks, the percentage of marks to be secured being lower in the case of the latter than in the case of the former. The grades of pay as recommended by the Central Pay Commission for the gazetted cadres are as under:—

Class I, Grade I	. Rs. 600—40—1000—1000—1050—1050—1100—1100—1150.
Class I, Grade II	Rs 350—350—380—380—30—590-EB—30—770—40—850.
Class I, Grade III	. Rs. 275—25—500-EB—30—650-EB—30—800.

Some time ago, the Central Board of Revenue came to the conclusion that the system of Examiners of Accounts helping the Income-tax Officers to arrive at the taxable income should be abolished, and towards this end such of the Examiners as were either qualified by the Departmental Examination or were otherwise suitable, were promoted as Income-tax Officers and to bring about this changeover, the number of posts of Income-tax Officers was increased in the proportion of two Grade III Income tax Officer's posts to three posts of Examiners. The grade of Examiners stands, therefore, practically abolished except for some special posts or where the present incumbents are unsuited for promotion to the grade of Income-tax Officers. The Income-tax Officer is now assisted only by Inspectors whose work is to collect information pertaining to assessments.

361. Assistant Commissioners are appointed by promotion from the ranks of Income-tax Officers except in the few instances where members of the I.C.S. were appointed to these posts prior to 1939 or members of the 'Pool' cadre have been appointed since. Until 1939, Assistant Commissioners' charges mostly corresponded to the Revenue Commissioners' divisions in the Provinces and they not only supervised the administration of the different Income-tax Offices within those Divisions but also heard appeals against the assessment orders of the Income-tax Officers within their jurisdictions. There were two scales of pay for Assistant Commissioners created under the 1922 Act. The ordinary scale of pay was Rs. 1,000—100—1,500, but for Assistant Commissioners in the cities of Bombay and Calcutta it was Rs 1,500—100—2,000 In or about 1927, the number of Assistant Commissioners for the cities of Bombay and Calcutta was increased from 1 to 2 and the grade of Rs. 1,500—100—2,000 was abolished, but the Assistant Commissioners in those cities were remunerated by a Special Pay of Rs 250 The Ayers Committee recommended that the functions of the Assistant Commissioners should be divided into appellate and administrative or inspecting. Appellate work was entrusted to the Appellate Assistant Commissioners who were to have no administrative functions but only hear and decide appeals that came to them against assessment orders passed by Income-tax Officers. The other duties of Assistant Commissioners were to be performed by Inspecting Assistant Commissioners whose functions were administrative and advisory. This recommendation regarding the bifurcation of duties between Assistant Commissioners was given effect to on the passing of the Act of 1939 A post of Direcotr of Inspection was also created, with the object that the Director of Inspection should be available to advise the Central Board of Revenue on matters relating to accounts and to inspect the work of Assistant Commissioners and of Income-tax Officers, particularly with regard to the use and valuation of accounts of assessees examined by them. The first Director of Inspection accordingly visited the provincial centres in pursuance of this object. He was given the status of a Commissioner.

362. The Commissioners of Income-tax are the provincial heads of Income-tax administration and prior to 1939 were recruited either from the I.C.S. or from the cadre of Assistant Commissioners of Income-tax. A member of the I.C.S. appointed to the post of Commissioner of Income-tax started on a pay of Rs. 2,250 whatever his own pay might have been in his grade and

rose to Rs. 2,750 by annual increments of Rs. 100 and, if posted to the cities of Calcutta and Bombay, received a Special Pay of Rs. 250. Other Commissioners were on the scale of Rs 2,000—100—2,500, with Special Pay of Rs. 250 at Bombay and Calcutta. Up to 1915, the number of Commissionerships was only six, of which not more than three at any time (and often they were less) were held by members of the I.C.S. . Since 1939, recruitment to Commissionerships is made partly by promotion from Assistant Commissioners of the Department and partly from officers of the Commerce and Finance Department 'Pool' of Officers. Four Commissionerships were reserved for members of the 'Pool'; but in recent years it has not been found possible to reach that number. In 1945, the number of Commissioners of Income-tax was raised to 13 for the whole of India by the division of the grade of Commissioners into Grade I and Grade II. Five of the posts of Commissioner were classed as Grade I posts and the rest were Grade II posts. The Grade I posts carried the pay of Rs. 2,000--100--2,500 and the Grade II posts were allowed only Rs. 300 more than their grade pay as Assistant Commissioners. The post of Director of Inspection was classed as Grade I Commissionership and a few posts were created in the Board's office carrying the pay of Grade II Commissioner. The scales of pay as revised under the recommendation of the Central Pay Commission are Rs. 1,800—100—2,000 for senior Commissioners and Rs. 1,300—60—1,600 for junior Commissioners.

363. Roughly, the Income-tax Department at present is manned in the Gazetted ranks in the Provinces as under:—

	Normal sanctioned strength	Additional or Temporary	Total	Available
Commissioners :				
Grade I . .				
Grade II	6	.		6
Appellate Assistant Commissioners	1	22	41	69
Inspecting Assistant Commissioners	7	6	33	
Income-tax Officers :				
Grade I .	144	48	192	46
Grade II .	131	51	182	61
Grade III . .	277	49	326	[illegible]
Supernumarary Trian Rseserve :				
Grade I . .	.	24	24	31
Grade III . . .	.	103	103	139
Inspectors	172	111	283	247

The Central Pay Commission has recognised that from the point of view of revenue, the Income-tax Department is now the most important one (page 150), and under its recommendation the scale of pay for Income-tax Officers is to be on par with that of the other All-India Services. Class 1 Income-tax Officers, Assistant Commissioners and Commissioners are now eligible for transfer all over India and in fact inter-provincial transfer are being effected, particularly of Commissioners and Assistant Commissioners.

364. The present method of recruitment of Income-tax Officers was thus evolved out of a quarter of century of experiment and experience. Even so, it has been criticised in all the replies that we have received to our Questionnaire on the ground that it has failed to secure the right type of men for the technical duties which the Officers have to perform in the Income-tax Department. It has, therefore, been suggested that the method of recruitment should be changed

and should be different from that of other Central Government Services, and that to attract men of integrity and with qualifications suited to the needs of Income-tax Service, the scales of pay offered to them should be higher than at present. One reply states:

"Psychological complexes induced by distinctions such as recruitment through F. P. S. C. has had an undesirable effect on the behaviour of the Income-tax Officers".

The Bengal Chamber of Commerce has said "men with the requisite initial ability will not be attracted to the Service on the present level of salaries, for the income-tax section suffers from a particularly acute competition from private sources of employment and the complexities of the taxation system create a demand for skilled and trained men". Others prefer, according to their professions, Law Graduates or R. As. and one, the Editor of the Income-tax Gazette, would like the recruitment extended to Income-tax practitioners of 12 years' standing. Another suggestion is that the recruitment may continue to be made from Graduates of high qualifications, but the recruits should be given a training in accountancy and should also be made to study for one year in a Law College. A few would extend the field of recruitment to business houses and suggest that suitable young men who have had training in these offices should be recruited to the Income-tax Department. Not an inconsiderable part of the replies would revert to the old system of initial recruitment in the grade of Examiners and through that grade to the Grades of Income-tax Officers. All are, however, unanimous in stating that the recruitment must be made from first class men with character and that these men, once recruited and properly trained, should have in the Department itself prospects which will keep them satisfied throughout the period of their service. All are equally insistent that promotions to the higher grades of the Income-tax Service should be on merit from the members of that Service; but, if men from other Departments are to be taken, they suggest that they should be recruited comparatively young, should be given full training in the Department before they are appointed to the higher posts and should not be allowed to leave the Department after they have had training and experience in the Department.

365. The proposal that the initial direct recruitment to Income-tax Service should be made through the cadre of Examiners has to be considered apart from the necessity for such a cadre. We have discussed the latter question later in this Report (see paragraph 412). We are not in favour of the proposal that Income-tax Officers should be recruited first as Examiners. Whatever advantage this suggestion might have from the point of view of training and experience, it has the great disadvantage that recruitment at the non-gazetted stage will not attract that class of persons of ability and integrity and also of mental equipment, from which it is necessary, as we have said later, that Income-tax Officers should be drawn.

366. For a like reason, recruitment from employees in business houses must be ruled out. If they are to be recruited for their practical experience of the rules of business, they can come in only at a late age. Secondly, the experience of one business may not be useful for another and one man cannot collect expert knowledge of the methods of accounting followed by different trades and professions within a short time. Thirdly, that impersonal outlook on assessees which is a primary pre-requisite for a successful Income-tax Officer cannot be expected in recruits of this class.

367. The suggestion that Income-tax Officers should be primarily recruited from the ranks of R.As. has also certain drawbacks. The mere passing of the examination of Registered Accountants can at best give the candidate a knowledge of accountancy which some University Examinations, particularly the B.Com. Examination, can also supply. An R.A. has only this advantage over a Commerce Graduate that he acquires also practical knowledge of accountancy

during his period of apprenticeship in well-established and reputed firms of accountants. If this experience is to be of practical use, it cannot stop within only the apprenticeship period; and, if larger experience is to be sought, the recruit would have passed the age limit prescribed for admission to Government Service. Further, Government may have to be satisfied with only second rate men, as really capable men may not be attracted by the scale of pay offered in the Income-tax Service and, if attracted for a time, the attraction will fade with the years as they come to notice the lucrative returns that private practice offers.

368. We would, therefore, prefer some method of recruitment, which will bring in the right type of men both in character and mental equipment at the right age and for the rest rely upon giving them a good and adequate training. It is obvious that an Income-tax Officer must possess a high standard of ability, mental alertness, tact and patience. While the knowledge of law and of accounts may be of great value in his equipment, a more important qualification is a high standard of integrity and character. A mentally alert person will not find it difficult with some training to adjust himself to the duties he may be called upon to perform, and, if endowed with perseverence and patience, he can in due course master the intricacies of accounts of law, required for the efficient discharge of his duties.

369. For lack of a better substitute, we would therefore prefer the continuance of the system of direct recruitment through the F.P.S.C. as the most suitable in the present circumstances. The choice of subjects prescribed for the F.P.S.C. Examination gives a wide scope for general intelligence and one who answers that test satisfactorily should be able, with due training, to acquire the other qualifications in practical accountancy and law, after recruitment to the Income-tax Service.

370. It was suggested to us, to avoid possible misfits, that a special examination might be held by the F.P.S.C. for recruitment to the Indian Income-tax Service. We see no advantage in such a separate examination. A separate test may not be very attractive because (i) it will limit the recruits to only one class of Service and (ii) it may not have the same prestige as an examination which has all along been associated with recruitment to All-India Services. We would, however, add that, if possible, some concessions might be made in such recruitment in favour of the special qualifications required for employment to Income-tax Service. If Accountancy and Law are not already included in the subjects that a candidate can offer for the F.P.S.C Examination, we suggest that they may be introduced for the purposes of the All-India test. To encourage candidates who have acquired a knowledge of law or experince in accountancy training to take this examination, a higher age limit may be allowed to such candidates to enable them to acquire the requisite qualifications and experience

371. It is inherent in any system of recruitment which is made on an All-India basis that it cannot always conform to the language requirements of all the Provinces it caters for. The direct selections made to the Income-tax Department during the last two years for vacancies both in Class I and Class II, have failed to secure an adequate number of probationers in some language groups while there was a surplus in other language groups. Consequently, in some Provinces, the recruits have had to be trained in the local language, before they could be placed on assessment work. Many critics of the present recruitment system have therefore attacked it on this, among other grounds, and have argued that such recruits cannot be expected to make good Income-tax Officers, as their unfamiliarity with the local language would operate as a handicap against local contacts and would also prevent them from entering into the spirit of the accounts written in an unfamiliar language. This handicap, it has been said, is likely to be felt more acutely, if linguistic provinces are established and the University or Court languages come to differ from Province to Province We do not consider this objection insuperable. If the English language could

be learnt and accounts in that language could be appreciated fully, there is no reason why an Indian language should be found to be more intractable. Income-tax Officers even in Class I are not generally transferred from one Province to another; secondly, the commercial languages are only a few which are to be found in every Province. The language obstacle may, however, operate against local contacts for some period, but given a fairly long period, even this obstacle will be overcome successfully To obviate this time lag, we would suggest that in the posting of recruits to Class I vacancies, the language of the recruits should be given weight, as far as possible.

372. In passing we wish to emphasize the danger of devoting attention exclusively to the importance of the gazetted ranks of the Service. The non-gazetted ranks of the Income-tax Department require men of as high talent and integrity. We think that with a view to securing talented men even for the non-gazetted ranks and to ensuring their efficiency and contentment, provision must be made for the recruitment to a certain number of vacancies by promotion from the non-gazetted ranks. The proportion of recruitment from the lower subordinates may be ⅓rd of the total vacancies in each year and such promotion should be made not on seniority only but more on merit combined with seniority. We would recommend that the promotees from the ranks, although eligible finally for selection to Class I Service, should be first promoted fairly young to Class II Service where they should be tried for a few years as Income-tax Officers and then taken to Class I Service and in this latter selection age should not operate as a bar provided the qualifications of ability and integrity are fulfilled. We would also recommend that once a person is promoted to Class I Service, no distinction should be permitted to be made on account of the method of his recruitment in his future prospects and promotion. This is the rule in other Services like the Indian Audit and Accounts Service, where the highest posts have, in some instances, been held by men promoted from the ministerial grades. In order to make the Service attractive, it is necessary to provide chances of promotion, and emoluments which will rise steadily with the length of service. This can be achieved by making the junior grade smaller than the senior grade, thus giving a larger scope for promotion, and by adding to the present number of posts on higher scales of pay. We have already recommend in paragraph 314 above that the permission given to the Commissioner under section 5(5) of the Income-tax Act to confer on Inspecting Assistant Commissioners the power to assess in specified cases should be freely exercised. This will have the double advantage (i) of utilising in really complex and important assessments the skill and experience of senior officers, and (ii) of improving the chances of promotion of Income-tax Officers, as these posts will be additions to Inspecting Assistant Commissioner's normal cadre and will virtually be Selection Grade appointments to the cadre of the Income-tax Officers.

373. As rightly stated by the Bengal Chamber of Commerce, in their reply the Income-tax Service "suffers from a particularly acute competition from private sources", and the evidence for this is to be seen in the number of men, with experience of the Department, who have found for themselves well-paid jobs in private employment. There was already a tendency even prior to the War, for young men to resign from the Income-tax Department on account of better prospects outside. This tendency increased during the period of the War and has not ceased even now The number of resignations, particularly from among the better equipped Officers during the War, was fairly large, considering the then strength of the cadre. That after resignation these persons have been earning very well either in private practice or in private employment has added to the temptation to others We consider a divided loyalty among this class of Government servants a potential danger to Government revenue and were sorry to find at many of the places, which we visited during this year, a widely spread feeling of discontent, dissatisfaction and frustration in the service. We, therefore, thought it desirable to invite representatives of the All-India Federation of Income-tax Gazetted Services Association and two

other allied Associations to New Delhi to give us their views. From what we heard from them and from what we read from the replies to our Questionnaire, we feel satisfied that there still exists a strong under-current of dissatisfaction in all grades of the Service owing to different causes. While the grievance appears to be universal that too much work is placed on too few persons, and that confirmations in all ranks are taking place at almost snail-like pace, the Gazetted Officers feel aggrieved at what they consider to be invidious distinctions against Income-tax Service in certain respects although it is now an All-India Service. Thus, it is considered by them to be a reflection on their ability and capacity that the seniormost posts of Commissioner are reserved to 'Pool' Officers, and that there should be at present only one member of the Income-tax Service in the 'Pool' Cadre. They also feel aggrieved at certain distinctions made to their disadvantage in the matter of travelling allowances, at the lack of proper facilities for work and of proper appreciation of work. Besides these general grievances, there were also special grievances with some of which we shall deal later.

374. We cannot, without further information, express any opinion on all the matters represented to us; but we have no hesitation in recommending that Government should remove all causes of discontent on the score of invidious distinctions, if any, and should assure by word as well as by deed that the members of the Income-tax Service will be eligible for the highest posts in that Service and that if reservations are made for posts in their service for persons from the 'Pool' Cadre, they will be compensated for such reservations by a corresponding number of posts in the 'Pool' Cadre for the Income-tax Service. Having regard to the present method of recruitment to the Income-tax Service, such assurance should not be difficult. If larger numbers than heretofore are recruited from the Income-tax Service, Class I, to the 'Pool' Cadre, we feel sure that the feeling of inferiority, which seems to weigh on the minds of the Gazetted Officers of the Department at present, will be greatly assuaged.

As the method of recruitment of Income-tax Officers was not till recently uniform in all the Provinces, the attempt to weld all the different scales of pay and prospects into one all-India scale has created certain inequalities and hardships, which were explained to us by the representatives of the Federation. Some of them, we think, are remediable and there should be no delay in remedying them. The Income-tax Officer is the linchpin of one of the most important and lucrative branches of the administration. He is expected to perform a difficult task with fairness and with justice to both the State and the public. To give justice, he must receive justice and also feel that he is receiving it. We, therefore, recommend that Government should treat with sympathy the grievances of the Department as they are brought to the notice of Government.

375. One of the grievances of the Gazetted Officers is the distinction made against the Income-tax Service, Class I, by the Finance Department with regard to T.A. Rules. While in most, if not all other, Class I Services, officers are allowed 1st Class fare, irrespective of pay, in the case of Income-tax Service, Class I, an officer is denied similar privilege until he reaches a certain point in his pay scale. This distinction is probably due to the fact that Income-tax Service, Class I, being a new service in that Class, is not included in the Annexure to F.R. 17. But, if a new entrant in an old Service is not debarred from the privilege it is not clear why a new service should be excluded. If there are obstacles, we think they should be made to yield to considerations of fairness. There are also other sound reasons to recommend the proposal *viz.*, that the Income-tax Officer carries confidential records when he goes on tour.

376. A more important grievance, which is shared at present by all ranks of the Service is the delay in confirmations. We were told that at least in

one instance an Income-tax Officer has been officiating for 14 years and 9 months and is still unconfirmed and there are many persons in the Department with 5 years to 8 years of officiating service who are still unconfirmed. The present position regarding the sanctioned strength, the normal strength and the permanent strength is stated to be as under:—

	Sanctioned strength.	Normal strength.	Permanent strength up to which confirmations can be made.
Assistant Commissioners	74	46	33
I.T.Os, Grade I .	192	144	119
I.T.Os, Grade II .	182	131	107
I.T.Os, Grade III .	326	277	209

As the figures in the first column relating to Sanctioned Strength might include a provision for arrears work, we may compare the normal strength with the permanent strength. The disparity between the two sets of figures is sufficient testimony to the genuineness of the complaint of the Federation, but the actual position of confirmations, we are informed, is even worse than that disclosed by the figures, because a number of permanent posts are also not filled up substantively on account of the incumbents of those posts officiating in the higher grades. We are told that the sudden expansion of the Department, the high level of arrears of work and the recent reorganisation of the Department have delayed action with regard to confirmation of officers; but the main hurdle appears to be the difficulty experienced in determining the minimum strength of each cadre to which the permanent strength is to be revised. The war has been over now for over three years and with it disappeared the main uncertain factor for framing an estimate of the size of normal work. 1947 introduced other complications, but they can hardly justify the holding up of even an estimate. We think that a stable quantum of assessment work for the country is not difficult to arrive at if a rapid survey is undertaken and help is taken of Commissioners' old records. While the search is being carried on for a stable minimum, arrears are increasing, which is indicative of a lack of confidence and enthusiasm among the Service, and also of inadequacy of the staff. There appears to be no reason to wait for another estimate of a stable minimum. Even if the present strength is found excessive later, the inevitable retirements in the next few years will give an opportunity to correct the estimate. A quick and fair decision on confirmations will give satisfaction which, we feel, will be reflected in better output We have stressed this point of confirmation deliberately because it affects all the cadres in the Department—Assistant Commissioners, Income-tax Officers Inspectors, Superintendents and Clerks. We think that a grievance like this which runs through all the ranks, is fraught with danger to the morale and efficiency of the Department and deserves, therefore, priority for consideration over other grievances.

377. Another aspect of this question of confirmations which was brought to our notice by the Federat on was the method followed in effecting confirmation. It was said that, in recent confirmations, some Assistant Commissioners were confirmed who were appointed as late as 1944, in preference to others, who had been appointed as far back as 1941. One reason was said to be the comparative superiority of the record of the confirmed Assistant Commissioners over that of those passed over; a second reason mentioned was that the seniority between the Assistant Commissioners at the time of confirmation was not determined from the date of entry into that cadre but according to the period of service in the cadre of Income-tax Officers, on the ground that promotions to posts of A.C. having been made in the past according to provincial requirements, in some Provinces comparatively junior Income-tax Officers came to be promoted earlier than their more senior counterparts in other Provinces. While these local considerations were considered in one class of confirmations, it

was complained that they were ignored for the purpose of determining seniority in another group of the same Class I Service. Thus, in Bombay and Bengal, recruitment was originally made at the stage of Examiners and not directly to the Gazetted Cadre unlike in other Provinces. By common consent the Examiners relieved I.T.O.s. of considerable part of their assessment duties satisfactorily and the Examiners were meant to be promoted as I.T.Os. Yet in the all-India seniority of I.T.Os. the service in the grade of Examiners is not taken into account, it being non-gazetted. Therefore, an anomaly like the following results: If an I.T.O., say in Bombay or Calcutta, who entered service in the Income-tax Department in 1923 as an Examiner became an I.T.O. in 1932, and was promoted as A.C. in 1942, he will at the time of confirmation in the grade of A.C. rank as a junior to an A.C. from the United Provinces, because the latter entered directly as an Income-tax Officer in 1928, although he was appointed to the A.C.'s cadre only in 1944. This lack of uniformity and difference in treatment between one class of officer and another is causing considerable discontent in the rank and file of the Income-tax Department. It is not obvious to us why when a person who has been appointed as an A.C. and is thought fit to continue in that grade should be passed over at the time of confirmation by another whose record is not appreciably better than his record. We think that if the continuance of a person in a certain post is not considered prejudicial to public interest, it will not be prejudicial to the same interest to confirm him in that post after sufficient time. To retain him without confirmation, if found unfit, only puts a man in a place he does not deserve; it promotes in efficiency and it prevents a more capable man from being promoted in his place. Thus, the loss to the Department is manifold. The way the criterion of length of service is applied also appears to us to be inequitable. We think that, if past service is to be treated in one way for one cadre, it is but fair that it should not be treated differently in another carde. While we see that there is force in the request made by the I.T.Os. from Bombay and Bengal that, as Examiners were virtually probationary I.T.Os., a proportion at least, if not the whole, of their service in that cadre should be counted for seniority, and although we would wish the grievance remedied, we are not making any specific recommendation on the matter only because we have had no time to ascertain other views on the subject nor the reactions of those who are likely to be prejudicially affected, if the claim was accepted.

378. Some officers have complained of the designation Grade III as applied to them. They would prefer Grade III Officers to be known as Class II Officers without mentioning the Grade. The objection is raised probably by senior officers who think that Grade III marks them out as inferior to Grade II which is generally composed of young men. We have no comments to make on this complaint, which is of a psychological character.

379. Another widely made complaint is that, owing to a deficiency of Class I officers, particularly in Grade I, a vast majority of Income-tax Officers in Grade III are being made to do the work which would ordinarily be allotted to Grade I or Grade II officers but with no additional remuneration to them. We find on enquiry that there is considerable truth in this complaint. We have known of a number of posts in the E.P.T. Circles, the Company Circles and in Special Circles being held by Grade III officers in charges which in some cases yield a very large revenue and yet no special remuneration is paid to the officers holding them. One of our Authorised Officials at Ahmedabad, who, even before being deputed to our work, was considered so reliable that he was placed in charge of some of the most important assessments, is still an officer in Grade III. We agree with the following view expressed by the Central Pay Commission in their Report (page 140): "But it will not be proper to post any person to duty usually pertaining to the senior service and yet pay him only on Class II basis". The Central Pay Commission seem to

have acquiesced in the continuation of Class II Service in the I.T.O. grade only on the assurance that Grade III officers are generally posted only to the least important charges, or used to assist senior officers (see pp. 151-52 of the Pay Commission Report). If the Government cannot find a sufficient number of Class I officers and are compelled to use Class II ones in their places, the proper course is either to appoint the Class II officers to Class I temporarily or to remunerate such Class II officers by additional payment for doing more important work.

380. According to another complaint, which has been voiced by both officials and non-officials, a number of persons have of late been taken into the Department from other Departments either from the I.C.S. or from the Finance & Commerce Departments' Cadre of Officers, known as 'Pool' officers, and it is urged that they are only birds of passage in this Department. Two of the seniormost posts of Commissioner of Income-tax, *viz.*, of Bombay City and of Calcutta City, each carrying a Special Pay of Rs. 250 are reserved for these 'Pool' officers to the detriment of the chances of the Departmental officers. It has been pointed out that these 'Pool' officers can at best remain in the Department only for a short time and, as soon as better prospects are available in other Departments, their services are transferred elsewhere, with the result that the experience they gain in the Income-tax Department is virtually lost not only to the Department but also to the public service. It has, therefore, been suggested to us that, if any recruits are to be taken from outside, they should be taken when comparatively young, that they should be taken not in the highest grades of the Department but at best as Assistant Commissioners, that they should not be promoted as Commissioners, until they have had a training of at least three to five years as Inspecting Assistant Commissioners and that, even after they are promoted as Commissioners they should not be allowed to leave the Department; but that, in order to induce them to continue inthis Department, they should be remunerated sufficiently so as not to suffer thereby in their prospects. We have every sympathy with the complaint and with the suggestion made. In the present set-up, there are only two Commissioners of Income-tax who are from the 'Pool'; but they occupy the most senior posts in the cadre of Commissioners, *viz.*, Bombay and Calcutta Cities, with only a short experience of the Income-tax Department. We do not oppose the system of introducing fresh blood into the Department from other Departments of the Central Government. In fact, such transfers are to be welcomed as they would introduce into the Department a class of officers with tried efficiency and ability. But, even with the best ability, specialised knowledge of the kind necessary for efficiency in the Income-tax Department cannot be obtained with a few months' probation in that Department. The Law of Income-tax is intricate and complex. The methods of accounting practised by assessees are varied and complicated. The problems of administration and of law tax even the best brains raised, as they generally are, by persons who are specialists in the different trades and professions. Therefore, to stand up to these complexities and intricacies, even an able man has to put in an apprenticeship sufficiently long to enable him to acquire not only general but also special knowledge of the different problems of the Department. The Commissioner, as the head of the Province, has to issue directions to his subordinates on individual points of law and procedure referred to him as well as on matters of general import, except such as are issued by the Central Board of Revenue. Unless the Commissioner is fully conversant with all aspects of the administration of the Act, he will fail to exercise adequate check on his subordinates, and to inspire that confidence among the assessees for his judgment and understanding which is necessary for the purity and popularity of the administration. We, therefore, strongly recommend that in introducing members of the 'Pool' into the Income-tax

Department, it should be made a rule that they must put in not less than three to five years of active and continuous service as I.A.Os. before they can be considered for appointment as Commissioners of Income-tax. Secondly, after appointment as Commissioners, 'Pool' officers should not be allowed ordinarily to have their services transferred to other Departments till at least five years after their first appointment as Commissioners. In order that the prospects of promotion of Departmental officers should not be reduced, we would suggest that at least two-thirds of the posts of Commissioners should be reserved for members of the Income-tax Department as their natural avenue of promotion.

Training of Officers

381. Under the present machinery of the Indian Income-tax Act, the Income-tax Officer is the only authority who brings on record the materials with reference to which assessments are to be framed. It is on these materials that not only the Income-tax Officer's assessments but also the inspections, the appeals and the references to the High Court are based. In the strength of the Income-tax Officer's materials lies the strength of the assessments and any weakness that the Income-tax Officer might introduce into the framework of his assessments weakens the later proceedings right up to the end. In the course of his duties the Income-tax Officer has, therefore, to know his charge inside out, know the character and the business activities of all his assessees. He must be an expert accountant to get within the short time at his disposal to the essentials of the assessee's income from the account books which are maintained by the assessee with the help of expert knowledge. He has to be not only able to pierce through the subterfuges played by the assessees but also to meet successfully on their own ground the accountants, the lawyers and the other experts that the assessee can and does engage. He must be able to judge the value of evidence and to frame an assessment in a spirit of judicial procedure. The recruit who is to fill this responsible role (if he is not promoted from the non-gazetted grades in the Department) comes to the Department fresh from the Universities, after selection by the Federal Public Service Commission. He is, therefore, trained and equipped for these responsibilities.

382. Under the present system, a recruit through the Federal Public Service Commission is given two years in which to qualify himself with experience and knowledge for taking on independent responsibilities as an Income-tax Officer. The first batch of trainees was recruited in November 1944. They were mostly recruited to Class II Service, as Income-tax Service, Class I, developed only later. We understand that the course of training this first batch went through, and which is also the training given to-day, with perhaps some little modifications, was as under:—

(i) As most of the recruits happened to be unfamiliar with the languages of the provinces where they were to work, they were instructed in these languages.

(ii) Side by side with this instruction, they were given lectures in Income-tax Law and Book-keeping in the first three months. In the fourth and fifth months preliminary tests were taken, which all of the recruits took successfully. From the sixth month, for half the day, that is, in the afternoon, the recruits were asked to study assessment files and to learn the method of examination of simple accounts. In the mornings, they continued to attend a course of lectures on Income-tax law, Book-keeping, special problems of accounts, etc. For further training most of the officers were attached to a General business ward; a few were attached to a Company Circle. This training continued for seven months. In

January 1946, the training course was completed and the trainees were sent to the respective provinces. Here till October 1946, most of them were not given independent assessment work, but they examined accounts and put up *pro forma* assessments which were scruitinised by Senior officers to whom these officers were attached for training. Within a period of two years from the date of their recruitment, they had completed the full course of training and had passed the Departmental Examination which was a test in Income-tax Law, Income-tax Procedure, Book-keeping, a Language test, both oral and practical, in accounts and they were then given independent charge of assessments.

383. While this training course followed in outline, the course of training given to Inspectors in the U. K., it was deficient, we think, in certain respects. The theoretical training given to the trainees was probably sufficient, but not so the practical training. It was defective in that the trainee had not enough practical experience of clerical work and had even less experience of outdoor work such as survey and enquiries, and had insufficient acquaintance with special types of accounts. As any deficiency in the initial training of the Income-tax Officer is likely to be felt throughout his career in the Department, we think that the training to be given to an Income-tax Officer should be improved in these directions. These defects are avoided in the U. K. system of training. In the U. K., the recruits, on selection, are appointed as Assistant Inspectors and they remain under training for nearly eight to ten years in all. First they are posted to a district. There they are put on training in clerical work. They merely study records and the method of work and, after a time, they are asked to be present when assessees are interviewed by the Inspectors. Later, they interview assessees themselves. They are given lectures and a practical paper is set on the lecture every week. After two years of such training and experience, the recruits have to appear for a test known as Treasury Preliminary Examination. If the result is satisfactory and the trainees are favourably reported on by the Inspector, they are confirmed as Assistant Inspectors. This concludes the first period of training. In the second period of training, which lasts for about 18 months to 2 years, the recruits move about to get more extensive training. They are placed where they can see the working of the higher organisation of the Department and more difficult assessments being made. Even then they work under the supervision of a senior Inspector. At the end of this period, they are made to appear at a Treasury Commission Examination, which is a more difficult test than the first one. On passing this latter examination and, if the report of the Inspector is favourable, they are appointed Inspector Assistants, in which capacity they are allowed to interview assessees on their own, assume responsibility and are gradually initiated into taking up difficult type of work. But this work is not passed until it is vetted by a senior Inspector. This period lasts for another four to five years. The total period of training is thus between eight and ten years, and it is only at the end of this period that a recruit is given independent charge of a District as an Inspector.

384. Such a course of training differs from the Indian method in two essential particulars. In this training, emphasis is laid on contacts. The trainee is present at the Inspector's interviews with the assessees for some time. Later, he interviews them himself, before even taking on the duties of an Inspector. Secondly, the trainee is moved about to familiarise himself with the different types and grados of accounts. We think the training in India needs the contacts even more than in England. Here the official and non-official elements in public life mix even less freely than in the U. K., and this obstructs the free flow of confidence and co-operation between them. The psychological complex of

the desk-chair worker and the unpleasantness of the levy of Income-tax, make the Income-tax Officer even less welcome than the other Government Officials. It is necessary both in the interest of revenue and of the smooth working of the Department that this barrier of reserve should be removed. The Income-tax Officer must learn to talk in the language of the assessee, both literally and figuratively.

(i) We, therefore, recommend that the course of training of an Income-tax Officer should include inquiry and investigation and survey work for a fairly long period, say for six months, during which period the trainee should be made to study method of business on the stock exchange, bullion exchange, commodity exchange and other similar exchanges, to collect information from Government and other records and to familiarise himself with the machinery of business in the principal manufactures and trades of the province.

(ii) He might also usefully spend at least a month in getting acquainted with the clerical work in an Income-tax Office, namely, the preparation of statements, the method of keeping registers, etc. This training will help him to keep a check on the lethargy and indifference of his subordinates.

(iii) He should spend some time, not less than a month, in a Refund Circle and also in a Salary Circle, so as to familiarise himself with the working of refunds and the method of maintaining the records of salaried persons.

(iv) It will be best to start him on the examination of accounts in a small Company district where he can study the Balance Sheets, the Profit and Loss Accounts and learn the method of enquiry into those accounts, which knowledge he will find very useful when he comes to examine account books placed before him. After this preliminary training, he should learn to work out assessable income in respect of properties and small business assessees. He can then be attached successively to a large Circle in each kind of business, namely, a general Circle, a Mofussil Circle, a Circle where assessments of wholesale dealers in textiles and other trades, Chemists and Druggists, etc. are made. Thereafter, an equal time might be usefully spent by him in a Circle with speculative sources of income such as stockbrokers, bullion brokers, etc. and he might end with the Companies Circle where he should examine accounts of Insurance Companies, Banking Companies and also acquaint himself with the methods of double income-tax relief.

385. In the course of his apprenticeship in the various districts, he should in the earlier stage examine accounts and place results before the Income-tax Officer for the latter to frame assessment orders and at a later stage when he has obtained sufficient experience, he might be made to frame *pro forma* assessment orders which the Income-tax Officer concerned might approve and adopt. Before completing the training, the trainee might usefully spend a few days with the Appellate Assistant Commissioner and a few days with the Departmental Representative at the Income-tax Appellate Tribunal. Here he will get to know what type of criticism assessment orders have to meet and how to meet it in his own orders, when he comes to make them. While we would adopt as the goal the U. K. system of training even for its length of period, we appreciate that the Department in India can at present ill afford such a long period of training. A suitable curtailment without materially affecting the efficacy of the training may therefore be made.

386. It has been suggested to us in some of the replies to our Questionnaire that even after the Income-tax Officers have acquired their full training and have put in some years of actual-assessment work, they should be encouraged to go abroad and to add to their knowledge by a comparative study of the Income-tax administrations in other countries. While the suggestion is too ambitious to be used as a part of the training of the Income-tax Officers, Government may consider whether it will not be worth while occasionally to depute

a senior officer or a specialist officer to study methods in vogue in other countries, both of administration of the Act and of assessing particular classes of income.

387. Under the recommendations of the Ayers' Committee Report, the role of Instructor was given to the Inspecting Assistant Commissioner, and this, under the present system, the Inspecting Assistant Commissioner would perform, after the trainee is given full powers of assessment. We have in another part of this Report referred in some detail to the present position held by the Inspecting Assistant Commissioner. Here, it will suffice, therefore, to say that out of the many causes that have sapped the initiative, the judgment and the discretion of the Income-tax Officer during recent years, the Inspecting Assistant Commissioner appears, from accounts received by us, to have contributed the most. The Income-tax Officer himself is often reluctant to seek the advice of his Assistant Commissioner, who is also his immediate superior, lest he be found fault with for his lack of knowledge or comprehension. The result is that the raw recruit avoids difficult questions by suppressing them or he always decides against the assessees in order to escape blame from his senior officer. He thus learns little. We think that the machinery for training should be such that the Income-tax Officer will not feel that mental reserve which he feels towards his administrative head and yet be able to get advice and be corrected whenever he commits mistakes. We would, therefore, suggest that the system of what is known in the Income-tax Department as the system of "Principal Officers" should be used more freely in the training of Income-tax Officers, even after they pass through the training course and are started as junior officers.

388. While on this subject of training, we should also point out that the Income-tax Officer, being both an executive and an administrative officer, has, for many parts of his duties, to depend on the assistance of his subordinates. We were told in Bombay that in practice few Inspectors were found useful and that everywhere except perhaps in one Province, clerical assistance is both inadequate and inefficient. We would, therefore, suggest that the non-gazetted subordinates in the Income-tax Department should also be made to undergo training which will enable them to make calculations of tax correctly and quickly and to render other assistance to the Income-tax Officer.

Organisation and Distribution of work

389. The present set-up of the Income-tax Department can be explained by the following chart:—

Central Board of Revenue

Commissioners of Income-tax.

Inspecting Assistant Commissioners of Income-tax. | Appellate Assistant Commissioners of Income-tax.

Income-tax Officers.

Inspectors.

390. The Central Board of Revenue was created under the Central Board of Revenue Act IV of 1924. The Ayers Committee Report of 1936 considered that the provisions of this Act did not invest the Central Board of Revenue with sufficient powers to enforce uniformity of practice and of administration throughout India and it therefore suggested that the Act should be amended so as to provide such powers of direction and control. Although the Central

Board of Revenue Act itself has not undergone any change following on this recommendation, the provision incorporated in the Indian Income-tax Act as it emerged from the Legislature in 1939, confer on the Central Board of Revenue powers to issue orders, instructions and directions to its subordinate officers (excepting the Appellate Assistant Commissioners in their judicial capacity) for the proper execution of the Act. Under the present constitution, the Central Board of Revenue consists of one Chairman and two Members, one of whom is the member for Income-tax. The Central Board of Revenue corresponds to the Board of Inland Revenue in England, but it exercises its powers of superintendence and instruction somewhat differently. In the U.K., the Board of Inland Revenue consists of a Chairman, a Deputy Chairman and three other Members, who are all permanent officials and are recruited from the Civil Service. They are responsible for the proper administration of the Income-tax law in the U.K. and issue general instructions to the Inspectors of Taxes to bring about uniformity of practice throughout the country. They are the administrative Heads of the Income-tax Department and they also advise the Chancellor of the Exchequer on all questions of public revenue and legislative proposals for the amendment of the Act whenever necessary. They have no power to reduce, cancel or enhance an assessment. In all these respects, the Central Board of Revenue functions similarly in India. But, the similarity stops here. In England, the Members of the Board of Inland Revenue are also *ex-officio* Special Commissioners. This body of Special Commissioners, whose official designation is "Commissioners for the special purpose of the Income-tax Acts", have certain definite functions assigned to them under the Income-tax Act. The most important of such duties are the following:—

(i) To hear and determine Appeals preferred before them,

(ii) To make assessments under Schedule 'D' at the request of any tax-payer, who prefers not to be assessed by the Central or the Additional Commissioners,

(iii) To make all assessments to Sur-tax,

(iv) To assess the profits of Railways and their officials in the U.K.,

(v) To make all assessments under Schedule 'C' on Interest and Annuities payable out of any Public Fund, except those made by the Commissionrs of the Bank of England, etc.,

(vi) To deal with re-payment of Income-tax, etc. and lastly,

(vii) To assign and allow assessments on Tax-payers who elect to be assessed by them instead of by the local Commissioners.

391. Below these Special Commissioners and working under the control of the Board of Inland Revenue is the Chief Inspector of Taxes who is assisted by a Deputy Chief Inspector and about 1,700 Inspectors administering different districts of varying sizes and importance throughout the length and breadth of the country. Below the Deputy Chief Inspector are the Principal Inspectors who are senior executive officers and are entrusted with the duty of inspecting offices. They generally specialise in different subjects in order to be able to give technical advice when asked for by the Inspectors under them. In some cases, if the importance of the duties justifies it, the Principal Inspectors are placed in charge of districts also. Next in rank are the Senior Inspectors who are each placed in charge of an area comprising several districts administered by a number of Inspectors. They are also inspecting officers who visit each district at least twice a year to examine and check the work of Inspectors. The Inspecting Inspectors are as a rule stationed in important cities and at Whitehall. The relations between them and the District Inspectors are as cordial as those of an elder brother towards his younger brother. The latter takes his difficulties to the former, who guides and instructs him. The inspections are more with a view to correction of mistakes than to find faults, and

also to test the calibre of the junior men. The reports are sent to the Chief Inspector. Each Income-tax district is in charge of one or more Inspectors who are divided into higher grade Inspectors, Inspectors and Assistant Inspectors. Roughly speaking, in the Districts, there is one Inspector for about 50,000 population. In London, there are 24 Districts with three to four Inspectors in each District. For clerical work, each Inspector is assisted by a clerical staff, but the actual collection of the tax is made by a separate official known as the Collector of Taxes.

392. Although these Inspectors are a British counterpart, in essential respects, of the Income-tax Officers in the Indian system, there is this difference that, while the Income-tax Officers make assessments, the Inspectors only aid in making them. Many attempts were made in the Indian Legislature, in the past, to introduce a similar system in India and to break the rigid official character of the Income-tax administrative structure in this country. We do not wish to reawaken the controversy. Although in the U.K., the association of the public with the administration of taxes has been fairly happy, the same cannot be said of other countries. Schultz, in his 'Public Finance', has the following:—

> "Elected boards of assessors all too often fall under the influence of dominant political machines and become focal centres of graft and corruption".

This is the experience in the U.S.A. In India, where business is much less organised and less educated than in the U.S.A., it is difficult to say whether the experience of associating non-official element with the administration will prove more satisfactory. The Inspector's work in the U.K. appears to be less difficult in some respects than that of the Income-tax Officer's in India. This difference is due mainly to the higher standard of education among the assessees in the U.K. and also to a higher sense of civic responsibility among the public. We are informed that in England, it is very rarely that books of accounts are actually examined by the assessing or appellate authorities, but that the assessees and their auditors prepare such elaborate and informative statements without any objection or reluctance that the Inspector is saved the trouble of wading through the large number of books, which, an Income-tax Officer in India has to examine and to interpret himself. It is usual in the U.K. for an assessee, even before he makes his statutory return of income, to agree as to his liability to tax with the local Inspector. This has two advantages, firstly, the assessment work is more evenly distributed in the U.K. than in India and, secondly, actual appeals are much fewer owing to the spirit of accommodation shown by both the assessee and the Inspector. Although the assessment year begins in the U.K. in April, some of the assessees start producing their statements before the Inspector in the previous September wherever possible and by the time the year of assessment opens, a number of the assessments are already agreed to. Although there was till recently no legal provision for calling for accounts, the assessees voluntarily produced them whenever necessary and gladly supplied whatever information was required by the Inspectors. This was so because the assessees knew that, if they did not agree with the Inspector about their liability, the latter might object to the assessments made by the General Commissioners and people preferred to avoid such a contingency.

393. The Ayers Committee Report recommended that the Central Board of Revenue might appoint a Chief Commissioner of Income-tax who would serve as a technical adviser to the Central Board of Revenue and would, subject to the general control of the Board, supervise and co-ordinate the administration of the Income-tax Act throughout India. To assist him in his duties, they suggested that his staff should include one senior Assistant Commissioner and one Income-tax Officer. They enumerated the various duties to be performed by this Chief Commissioner and his staff in Chapter XVI,

section 4 of the Report). Although this recommendation of the Committee was not immediately accepted, an officer designated the Director of Inspection was appointed in due course to assist the Board. We understand that at present the sanctioned strength of the Directorate of Inspection is one Director, two Additional Directors and an appropriate staff. Although the duties of this Directorate are not specifically defined in any Office Order, it is understood that the Director of Inspection has to supervise the inspection of Income-tax Offices by the Inspecting Assistant Commissioners and Commissioners, to keep an eye on the progress of assessment work so as to bring it up to date, to help the Central Board of Revenue to judge the work of the different classes of the Board's subordinates, to supervise the assessment of war time contractors, to superintend and give instructions on special assessments under the instructions of the Board and also to collect information through its Collation Branch from various organisations and Government Departments and to distribute such information to the different assessing units. Out of these duties, the one that engages most of the time of the Director of Inspection is evidently the scrutiny of the inspection reports that reach the Directorate through the Commissioners from the Inspecting Assistant Commissioners, in the various provinces. It is said that there are 31 Inspecting Assistant Commissioners, each one of whom is expected to inspect two offices in a month so that the Directorate should receive about 62 Inspection Reports every month which is work sufficient to keep more than one officer entirely busy, if he is to scrutinise every report and to pass orders with regard to most, if not every item. We must say that we are not much impressed with the necessity of a routine scrutiny of Inspecting Assistant Commissioner's inspection reports by the Directorate and of engaging three full time Commissioners on this job. Apart from purely office inspection, inspection work in the Income-tax Department has two aspects. It has to examine the materials that are brought on record by the Income-tax Officer for their sufficiency and, secondly, it has to see that the application of the provisions of the Act to such materials is proper and adequate The inspections in Income-tax Offices differ materially from those in other Offices and Departments. An Officer inspecting the latter has access to all the sources of information from which the material to be inspected is drawn. He is therefore able to test the capacity of the Officer to judge the value of the material as well as to apply it properly. In an Income-tax Office, on the other hand, no one but an Income-tax Officer has at present access to the original account books from which the materials, which form the basis of the assessments, are extracted. If he fails to bring on record any material or overlooks or misjudges any important item from the accounts that are produced before him, an inspecting officer cannot correct such omission or oversight unless they are patent from other facts or are obvious. An inspection by an Inspecting Assistant Commissioner is therefore more often than not an expression of a second opinion on the Income-tax Officer's materials An Inspecting Assistant Commissioner might, and often does, suggest further lines of enquiry; but for such guidance and suggestions, three checks are too many, considering that an Inspecting Assistant Commissioner himself is an experienced officer of the Department. In the ordinary course, his inspection report would go with the replies of the Income-tax Officer concerned to the Commissioner, who would then decide on the course of action to be taken. The present system of a third examination by the Director of Inspection was probably considered advisable, when the Commissioners drawn from other Departments were new; but, if our proposal that no Commissioner should be appointed to the post who has not had five years' experience as Inspecting Assistant Commissioner is adopted, such third inspection would, we think, be superfluous. The Commissioner has his legal advisers for questions of law; on questions of fact, the views of the Income-tax Officer and of the Inspecting Assistant Commissioner should bring out all the facts of the case. As the Director of Inspection also cannot himself examine accounts, he can hardly

import anything new through his further inspection. We would, therefore, suggest that, although the reports might continue to be sent to the Director, his function should be only to collate the major defects disclosed by the Inspection Reports, and to issue instructions of all-India character, to avoid repetition of those defects. He might also test, at his choice, assessments by the method of 'sample check' which is practised in the U.S.A. Such check is made with the help of a small 'flying squad' of Accountants, who settle for some time in a town, then in some section of a large city, to examine assessments, then move to some unspecified destination, thus covering a few thousand assessments in a year. For such test to be effective in India, this squad will have to be given the right to call for accounts and information such as is given to the Income-tax Officer. The wider knowledge and experience of the Director can thus be made still available without its being diffused on individual cases and in allocating blame in small matters.

394. The time of the Director of Inspection thus saved, may be utilised by him to better advantage. We accordingly recommend that the following may be made his special province in the Income-tax Administration:—

(a) the organisation and superintendence of Inquiry work of the Investigation or Inquiry Branch,

(b) watching the methods of recruitment and the quality of recruits and applying an Independent check upon recommendations for promotions,

(c) the drawing up of comprehensive instructions as to the method of examination of accounts in special types of cases,

(d) arranging for the systematic training and the departmental examination of probationary officers,

(e) periodical review of the method employed and registers and forms prescribed in connection with various branches of work,

(f) the requisition of periodical reports of progress in respect of assessment work and refund claims and the periodical revision of statistical requirements with a view to making the published returns as informative and intelligible as possible.

(g) In another place (paragraph 403) we have suggested the formation of Special Assessment Circles to secure uniformity of procedure and of method of assessment, and, the advantage of specialisation. As such assessment Circles are likely to be spread over more than one province, particularly in the case of large industries, they can be best supervised by a central machinery, and this may be made the special responsibility of the Director of Inspection, who, in effect, is the technical arm of the Central Board of Revenue. We suggest that the Director of Inspection should be assisted in this task by specialists of the rank of junior Commissioners or at least senior Assistant Commissioners who will have specialised in Banking accounts, Textile industry accounts, Insurance business accounts and accounts of such other industries, trades and businesses as, by reason of their importance, special characteristics and numbers, call for specialist treatment. In the U.K., a similar system is in actual operation, with its Specialist Principal and Senior Inspectors attached to the office of the Chief Inspector of Taxes, and in India the proposal had the support of Ayers Committee.

395. If the Director is to perform the above-mentioned duties without resentment from or conflict with the Provincial Heads of Income-tax administration, he should have, we think, a status superior to the Commissioners, and

as, under our proposals, the emphasis will be shifted from the duties of inspection to other duties, we would revive the recommendation of the Ayers Committee and suggest that the designation of the Officer may be changed from Director to Chief Commissioner of Income-tax with the status corresponding to that of the Deputy Chief Inspector of Taxes under the U.K. system.

396. In the Provinces, the Commissioner of Income-tax continues to be theoretically the administrative head of the province for income-tax purposes. In practice, however, owing to increasing centralisation at the Central Board of Revenue, the powers of the Commissioner have been so hedged round with restrictions and directions with regard to decisions on penalty provisions, difficult cases, and even in respect of some routine matters, that one who was formerly a powerful Provincial Potentate for Income-tax, who could make appointments to posts carrying Rs. 100 to Rs. 1,500, is today more or less the interpretor of the Income-tax Officer and the Inspecting Assistant Commissioner of Income-tax to the Board. We were told that one of the ideas behind the recommendations of the Ayers Committee was to reduce the importance of the Commissioner. We had it from Mr. Ayers that the model, which the Inquiry Committee, of which he was a Member, placed before it was the British model As under it, the Inspecting Assistant Commissioners like the Principal Inspectors were to control and guide the Income-tax Officers under the instructions of the Board, who would correspond to the Cheif Inspector of Taxes and to whom they would report through their inspections on the work of their subordinates. The Commissioner was accordingly to function, if not purely, at least mainly, as the administrative head and need not, therefore. be as highly paid as he is now. It was the Committee's intention that the expenditure that would be thus saved by reducing the pay of the Commissioners could be utilised for the appointment of technical experts working with the Board who would issue instructions on technical matters, the Member of the Central Board of Revenue thereafter confiing himself to matters of policy and administration as the Board of Inland Revenue does in England. This idea evidently did not either commend itself to Government or was not properly interpreted to them. Therefore, Commissioners still continue to be as highly paid as before and no technical experts have been appointed; but, all the same, the scope of their powers and functions and their influence have been seriously curtailed. We have already said above that we do not approve of the Directorate of Inspection doing more than supervisory duties in connection with inspection reports. The duty of judging and acting on inspection reports would, in this view, fall on the Commissioners, who, to function properly and without restraint, should be left free to decide on points thrown up by day to day administration, *e.g.*, penalties, individual assessments, etc.; this should neither cause loss of revenue nor raise any misgivings about the correctness of the decisions taken, if, as proposed by us, the Commissioners are, in the future, trained men. If any mistakes are committed, they can be corrected by the Member, Central Board of Revenue, or by the Chief Commissioner when they visit Provincial Headquarters. This proposal has the advantage that it will cut the many delays that at present occur in obtaining orders from the Centre and that it will improve the prestige and status of the Commissioner, both with the public and with his subordinates, and will enable him to exercise better control over his staff. As a man on the spot, the Commissioner's judgment is likely to be more correct than that of an authority however able and experienced, which is stationed hundreds of miles away, and which has, therefore, less opportunity to appreciate local conditions and the local point of view.

397. In another part of this report, we have referred to the duties to be assigned to Inspecting Assistant Commissioners and we have also dealt with Appellate Assistant Commissioners. Here we would only emphasize that if inspections by Inspecting Assistant Commissioners are to be effective and

instructive, the latter must have the power, when they consider it necessary to do so, to call for and examine account books equally with the Income-tax Officers under their charge. We would also recommend that both while exercising their administrative powers and in doing their inspection duties, the Inspecting Assistant Commissioners should place before themselves the example of the Senior Inspectors in the U.K., whose relations with their juniors, as we have mentioned already, are described to be those of an elder brother towards a younger one. We emphasize this point because during our visits to various centres, we heard comparatively senior Income-tax Officers expressing themselves bitterly over the manner in which even junior Inspecting Assistant Commissioners commented upon their work

398. We now turn to the suggestions made regarding the arrangement and distribution of work in Income-tax Offices. The existing arrangements have been severely criticised both by the public and by the Departmental men, although on different grounds. Under them, the Income-tax Officer is in charge of a tax district, comprising roughly about 1,000 assessees of all classes of income except where the assessees are arranged without reference to area and on a different principle. He calls for Returns of Income annually from the assessees, accepts some as correct, examines others for their correctness and where Returns are not made or reliable accounts are not produced, he estimates the incomes to the best of his judgment and finally collects tax on the basis of his assessments. In performing these duties, placed on him by the Commissioner, he works under the latter's orders conveyed through Circulars and other directions through the Inspecting Assistant Commissioners. Such orders cover all aspects of his work: the output, the method of assessment and the manner of collection of tax. It is the general complaint against this system that it is too rigid in its approach to the problem of fair assessment and that, limiting, as it does, the discretion of the Income-tax Officer both as regards the quantity of work and the manner in which it is to be performed, it does not make adequate provision for differences due to local custom, or the individual psychological 'twists' of assessees, which are inherent in any social and economic problem. The quota system of work is criticised on this ground and it is attacked also on the ground that the 'standard unit' on which the quota is based is too high. The standard unit and the quota for each Officer are arrived at as described below.

399. All assessment cases are classified into four categories—

Category (I) includes business incomes of over Rs. 25,000; Category (II) includes business incomes between Rs. 10,000 and Rs. 25,000; Category (III) includes business incomes between Rs. 5,000 and Rs. 10,000; Category (IV) includes all other business incomes except Category (V), and Category (V) includes salary, refund and 'no assessment' cases. The standard of work fixed for officers of respective grades is fixed on the basis of a 'standard unit'. One standard unit is equal to either one Category I assessment or five Category II assessments or ten Category III assessments or fifteen Category IV assessments or twenty Category V assessments. For annual output, the standard fixed is one Grade I Officer for every 185 standard units, except in the case of Bombay City and Calcutta and certain other important Circles, where the standard is fixed at 175 units. For a Grade II Officer doing only Category II and Category III assessments, the annual output is fixed at 150 units in Calcutta and Bombay and other similar places and 170 units elsewhere. For a Grade III Officer, the standard fixed for annual output is 90 units in Bombay, Calcutta and similar places and 110 units elsewhere. This standard is departed from in charges which deal with purely salary and refund cases. Other things being equal, it is asuumed that a Grade I Income-tax Officer will deal with Category I cases only, a Grade II Income-tax Officer will deal with assessments of cases under Category II and Category III, and a Grade

III Income-tax Officer will deal with cases under Categories IV and V. The number of Income-tax Officers required under the three Grades is estimated with reference to each Income-tax assessment charge by dividing the total number of assessments of various categories in that charge by the standard units.

400. This allocation of work by categories and the fixation of standard output in terms of standard units has been in vogue for two financial years. It has been stated in some quarters that instead of helping to reduce the arrears or to improve the quality of the work, the experiment has only created slipshod work and inefficiency. We do not think this judgment on the scheme can be accepted as either final or correct. The scheme has not yet had a fair trial for lack of Officers of the right categories in sufficient numbers. It has been suggested to us that the Income-tax Officer should be left to himself to deal with any case without any such standard. as, being a Gazetted Officer in charge of important work, he is expected to know his responsibilities and to discharge them to the best of his abilities. While we do not dispute the latter assumption, it cannot be denied that some yard-stick is necessary by which to judge the difference between one officer and another and to allocate blame or credit. We, therefore, do not disapprove of setting a standard for camparison, but at the same time we feel bound to recognise that a rigid standard of the type prescribed is not likely to do justice to Income-tax Officers, particularly in Circles where assessees combine in their activities more than one kind of business, or when the business is one but its ramifications are many. Thus, an Income-tax Officer of Grade III, in whose work 'no assessment, cases are included, is expected to do 90 units, *i.e.*, 1,800 cases in a year. A Speculator very often makes losses and, therefore, his case may be a 'no assessment' case for some years. But to complete the assessment even in such a case, the Income-tax Officer has to examine transactions over a number of "settlements" or "vaydas", depending on the type of speculation and many transactions in each "Vayda". It is, therefore, unfair to expect an income-tax Officer to deal with a large number of such cases in one year considering the ramifications of such business. . Similarly, even a Commission Agency business can earn Rs. 25,000 a year and it is a matter of a few minutes only for an Income-tax Officer to deal with such assessments and yet such assessments are classified under Category I. A salary earner may own shares and in deciding his case, the Income-tax Officer has to do a number of calculations for rebate of tax. From our own experience, we can say that no two cases are exactly alike and that one case may sometimes take more than a fortnight to conclude. Moreover, there are some items of work, some directly connected with assessment and others indirectly, of which no account is taken in fixing the outturn of an Income-tax Officer. The following are some of such items:—

(i) Supplementary Assessments under section 34,

(ii) Re-assessments under sections 27, 33 and 33A,

(iii) Re-examination of accounts when cases are remanded by the appellate authorities,

(iv) Examination of accounts for reporting incomes of branch businesses where the assessments are made by other Income-tax Officers or in other Provinces.

The yard-stick, we presume, was prescribed because it was intended that the Central Board of Revenue through the Director of Inspection should be the authority to judge about the quantity and quality of work of each Income-tax Officer. This again might have been all right as an experiment when the Commissioners of Income-tax were new or inexperienced. But considerable experience has been gained since the system was introduced in 1946. We think

it is time now that it should be left to the local Commissioners to judge what cases involve what quantity of labour. They and their Inspecting Assistant Commissioners should know the assessees better or at least should have better opportunities to judge of the quantity of labour involved in important cases. If an Inspecting Assistant Commissioner, at the first inspection, divides or classifies the cases in each charge in his jurisdiction according to the nature and quantity of work involved in them and arranges them into categories I to V. not based on the income but on the quantity of labour likely to be involved, a better and more equitable standard will be evolved for a quantitative value for each Income-tax Officer's work. There will be less inequality and a more correct marking by the Commissioner of the industry or otherwise of his officers. The Commissioner's report—monthly or periodical—will then be sent to the Director of Inspection and the Central Board of Revenue for record and such action as they deem fit. It is, no doubt, true that even in such a scheme, inequalities due to difference of opinion may persist. But they will be less and can be remedied on representation. The Director of Inspection or the Member of the Board during his annual visit may, if they are not satisfied, examine the classification.

401. In defining the charges and in allocating work on the time factor, sufficient allowance should be made for all the different facets that the I.T.O.'s work presents. This we think is not being done now, at least adequately. The Income-tax Office is not a machine into which accounts can be thrown at one end and the assessment can be taken out at the other. The I.T.O. has to sift to correlate and to judge in proper perspective the materials he collects, and unless sufficient time is allowed for these processes of mind to take their proper course, the work will suffer in quality. We think it therefore necessary that in fixing a fair standard of work, sufficient time should be left to the I.T.O. and to his inspecting staff for study and for application of tests, which again should not be judged on the result of such tests but only on their nature or character.

402. We would also suggest that, as far as possible, single I.T.O. jurisdictions should be avoided. Multiple I.T.O. jurisdictions are more easily adjustible to circumstances, It may be worth while to go even beyond district boundaries to achieve multiple Income-tax Officer jurisdiction, because in a system of administration where different classes and categories of officers work, with their limitations of experience and knowledge, it is best to have a group with officers of different grades and experience to deal with the different kinds of assessment that each charge has inevitably to handle. A group has in it a resilience and a reserve strength and will offer a greater resistence to sudden changes and strains. Thirdly, a group is very necessary for the training of new officers and the trying out of the old ones and, fourthly, in a group it is more easy to arrange for vacancies on leave or otherwise than in single officer units.

403. It is common knowledge that all businesses do not run to a pattern. Many have peculiarities of their own. In some businesses, these peculiarities can be learnt with a comparatively short experience. But others call for intensive and prolonged study to gain the experience necessary to understand and appreciate the accounts and to interpret them or find out flaws in them. If the latter class of assessment cases are dealt with as ordinary cases, not only is the revenue likely to suffer but the assessee is also likely to be put to the trouble of preparing unnecessary statements, which exasperate him without bringing any benefit to the Revenue. In the interests of efficiency and for the advantage of revenue, we would therefore suggest that selected classes of assessments should be made by specialist circles and to function in these circles, officers should be trained in the peculiarities of accounts maintained for these classes of businesses. What classes of assessment should be selected for such specialist treatment will depend on the quality of the business as also on the

number of assessees in that class. Thus, for assessing Textile Mills, we suggest that separate Circles should be formed with officers who have acquired technical knowledge of the sources of the raw materials and the methods of production, the percentage of wastage, the quality and value of labour employed the mechanism of sales and distribution, etc. As Textile Mills are situated in Bombay, Ahmedabad, Kanpur, Calcutta, Coimbatore, Madras, Delhi and other places, groups of textile-trained officers should be stationed at each of these places. To avoid the staleness that might set in if the same man is placed at the same place on one set of cases, all the textile groups should be brought into an All India Textile Circle, to enable officers from one group to be periodically transferred to another. Such a textile circle should be placed under one or more Commissioners according to the number of Income-tax Officers in the Circle, whose headquarters may be fixed in Bombay as in that city and Ahmedabad which is in the vicinity, the number of textile mills is the largest. We would suggest similar arrangements of work in respect of assessments relating to Insurance Companies, Banking Companies, Mining Companies, Iron and Steel Companies, share and stock brokers and any other type of important businesses that Government may think extensive enough and also important enough from the point of view of revenue to justify special attention. To make it possible to appoint a sufficient number of Commissioners without area jurisdiction, the present restriction of such Commissionerships to three in section 5 (2) of the Income-tax Act will have to be removed, by the deletion of the words "*not more than three in all*" in that section. The establishment of Circles of this specialist type should help towards efficiency and speed, particularly if they have also guidance from specialists who, as recommended by the Ayers Committee, should be maintained by the Central Board of Revenue at its office in New Delhi. They will work under the Director of Inspection or the Chief Commissioner of Income-tax by whatever name that authority may be called.

404. The only objection which we have so far heard to this proposal, which has been otherwise generally supported, is on the score that specialisation in one industry might not fit in with the method of promotion and recruitment in an administrative department like the Income-tax Department. It was argued that a person who, for instance, specialises in a banking business will be wasted if he is appointed as Inspecting Assistant Commissioner in a Textile Group where businesses other than banking are assessed and, secondly, that if a man is placed in charge of the same type of work year after year, he is likely to stagnate and to lose his broadness of outlook and of mind. We do not think that the dangers of the kind expressed are as great as they theoretically appear. It is common knowledge that insurance men have proved capable administrators and legislators, that bankers have contributed not a little in other walks of life to the progress of the country. Therefore, assessment work being essentially the same, the mere fact of a person specialising in one type of assessment is not likely to make him one-sided and impervious to peculiarities of other types of assessment. Secondly, if the groups are sufficiently large, higher posts in the groups will be available under the scheme itself and, if not available, as we have suggested, the specialist Income-tax Officer, if of sufficient seniority, might be given Inspecting Assistant Commissioner's pay and status under the powers of the Commissioner under section 5 (5) of the Income-tax Act. On the other hand, the advantages of specialisation are certainly greater than any minor inconveniences that the system might introduce

405. While on this subject we may refer to a suggestion that was made to us as an alternative to the above, namely, that for specific industries, Income-tax Officers should be appointed from among persons who had actually worked

in that industry or trade. We have already referred, while dealing with recruitment, to this proposal and, as was expressed by us there, we think that it would cramp the Department too much if recruitment is also made on specialist basis, that to make such recruitment properly effective, a number of officers of the specialist class would have to be recruited which would be out of all proportion in most industries to the necessities of the case and, thirdly, there would be other difficulties about age and the suitability for Government service.

406. An alternative to special recruitment was also suggested, *viz.*, that a panel of experts in each line should be selected by Government who may be available for advice of a technical nature whenever required by the Department. There is this disadvantage in such a scheme that these panel members would mostly be men still in the business and the persons about whom enquiries would have to be made would also belong to the business. It would therefore, be placing the experts, whose advice is sought, in a very embarrassing position, if their opinion is to be asked on matters relating to their rivals and the dangers are so obvious that we need not stress them any further.

407. *Arrears.*—In many of replies, the chronic state of the arrears has been pointed out as proof of the inefficiency and weakness of the administration. A retired Commissioner of Income-tax, whose experience and age justify consideration of his views, attributes the present state of things to the inability of Income-tax Officers on account of their inexperience to distinguish between case and case, as to the time to be devoted to each, and to their incapacity to come to quick decisions, the latter being the result of frequent interference from higher authorities. Arrears are not peculiar to the Income-tax Department. They are in some measure due in this as in other Departments, to past and present insufficiency of the staff. In the Income-tax Department, they are due secondly, to the lack of adequate assistance to the Income tax Officers, thirdly to incorrect distribution of work, and fourthly to the inexperience of Income-tax Officers and their consequent inability or unwillingness to come to a decision.

408. At the outbreak of the last war, the Income-tax Department was working to an income of about Rs. 18 crores, and was just trying to accustom itself to radical changes introduced by the amending Act of 1939. It was, therefore, unprepared for the sudden increase in the responsibilities which devolved on the Department as a result of the Great War. This was understandable; but that it did not adjust itself to the impact even as late as 1942-43 when the effect of the war came to be seriously felt, following the entry of Japan into the war, can only be due to the machinery being too rigid to absorb the shock or the incapacity of the administration to appreciate the increase in its responsibilities, which, every one else saw was inevitable. For some time, the machinery had been getting rigid and some arrears had been accumulating; but. the heavy arrears really commenced gathering momentum in 1939. The Income-tax Act as it emerged in that year had many new features especially the distinction between a resident and a non-resident person. In conformity with these alterations in the basis of taxation, the form of Return of Income had necessarily to be changed. Yet, because this was not foreseen or because the printing machinery failed, the Forms of Returns of Income under section 22 of the Act were not available for issue by the Income-tax Officers till about the middle of September 1939. Thus fully six months of the assessment period of 1939-40 were lost to the Department and the year ended with the accumulation of arrears, which was the heaviest till then. Succeeding years, weighted by war conditions, gave no opportunity to the staff to catch up with these arrears; on the contrary, they added to the arrears in all branches of the administration. The figures of arrears of assessments

are as under:

At end of 1944-45	1,81,282
" " " 1945-46	2,26,689
" " " 1946-47	3,03,296
" " " 1947-48	3,85,700

This increase in arrears of assessments again was due in no small measure to the failure as well as inability of the Department to recruit adequate staff even while imposing additional burden of work to meet the demands of revenue created by the war. It stands to the credit of the Income-tax staff of all ranks that in spite of the strain thus placed upon it, it did it's work valiantly during the crucial years of the war and collected, for Government, revenues out of all proportion to what they were called upon to collect before the war.

409. The following statement illustrates the increase in receipts from income taxation for Bombay City in the three selected years and the staff that was responsible for these receipts:—

Years of assessment	Total Revenue (I.T., S.T., EPT net).	No. of Income-tax Officers.	Total No. of non-gazetted staff. Executive.	Others.	No. of A.Cs. IAC	AAC	Total Expenditure.
1938-39 (City) (whole)	3,50,98,824	31	135	375	4		13,34,072
1939-40 City . .	3,66,08,094	23	131	315	1	2	11,88,720
Central .	*27,32,873*	*7*	*3*	*24*	*1*	*2*	*39,028*
	3,93,40,967	*30*	*134*	*339*	*2*	*2*	*12,27,748*
1944-45 City .	61,16,20,000	35	155	444	3	3	16,97,447
Central	*3,32,60,570*	*12*	*12*	*31*	*1*	*1*	*2,74,303*
	64,48,80,570	*47*	*167*	*475*	*4*	*4*	*19,71,750*

The sudden increase in the revenues in the last of the three years was not entirely a windfall. It had to be worked for through an entirely new enactment *e.g.*, the E.P.T. Act and by additional levies of Surcharges, etc. Owing to E.P.T. in most of the big assessments, assessment work was duplicated and with the introduction of the Surcharges, provisional assessments to Excess Profits Tax, the deposits and the advance payments, clerical work was almost quadrupled, besides making it complicated. In 1947-48, Excess Profits Tax remained only in cases then in arrears. Yet the corresponding figures for that year are as under, approximately:—

	Total Revenue.	No. of Income-tax Officers.	Other Staff Executive	Others	IAC	AAC	Total Expenditure.
1947-48 City .	47,17,97,000	136	110	769			33,04,744
Central	2,18,40,486	8	8	45			2,19,636

The number of assessees in the two years, 1944-45 and 1947-48, were 63,134 and 68,712 respectively for both Bombay City and Bombay Central combined. These figures are sufficient to establish that during the war years, 47 Income-tax Officers were doing the work, which, on the standard of work considered equitable in 1946 would have required the services of about 144 Income-tax Officers. Perhaps, the latter number includes a proportion for arrears. Even if ⅓rd. were allocated to arrears, it is obvious that an Income-tax Officer up to 1947-48 was doing the work of more than two in a period which commenced with a new Act and saw annually additions to the tax structure of a complex and intricate character.

410. Partly on account of the fact that the Income-tax Department was partitioned out of the Provincial Revenue Establishment and in its initial

stages was more tolerated than encouraged, and partly because of the fact that many of the superior officers, with whom the decision lay to increase the staff or to organise it, had no actual experience of the practical working of an assessment and the labour it involves (having come from Departments where their duties were cast in an entirely different mould) the Department has never been able to reach that resilience which can absorb shocks and adjust itself to new demands. It has been working mostly from hand to mouth in the matter of its staff and even today, the Reorganisation Scheme, to judge from increasing arrears, evidently has failed to provide for the Reserves necessary to meet casualties, additional duties, etc. This is a great drawback in an organisation, which is mostly technical in its make-up and administrative only secondarily. Owing to its character, it cannot immediately cover up its deficiencies of staff from the open market like other Departments, but has to allow at least a year to its recruits to train themselves. On the assessment side, it has lost its resilience to a certain extent owing to the abolition of Examiners with whom, at their back, the Commissioners in the early years, were able to enlist even comparatively raw graduates into service as Income-tax Officers. With the abolition of the grade of Bailiffs, who corresponded to 'Collectors' in the English system, recoveries have suffered and by imposing on clerks the same pay as in other Departments but more intricate and responsible duties, the recruitment has deteriorated and discontent has increased. While we do not disapprove of the changes in the administrative structure, we think that before making the changes, alternative machinery should have been created. Taking the structure as it is planned, we think, that it requires to be strengthened and rearranged immediately in certain respects, if the heavy arrears are to be reduced; and, above all, a liberal provision has to be made for Reserves in all grades and classes of the establishment, for emergent work.

411. From the figures available in the latest printed All-India Income-tax Reports and Returns for the year 1944-45, assessees can be classified into income groups as under —

	Salaries No. of cases. (1)	Individuals Tax. (2)	Salaries & other sources (3)	All other sources. (4)	Hindu undivided family. (5)	Firms. (6)	Cos. (7)	Total (8)
Incomes upto and inclusive of Rs. 7,500	1,27,881	9,418,084	34,315	93,293	51,004	10,782	2,262	3,19,637
Incomes above Rs. 7,500	20,331	6,36,578,402	13,728	37,065	24,168	4,209	4,135	1,03,536
Total incomes assessed.	1,48,212	64,59,96,486	48,043	1,30,358	75,172	14,991	6,397	4,23,173

It will be noticed from the above figures that nearly ⅔rds of the number of assessees in a year are drawn from income groups below Rs. 7,500 and only ⅓rd. are drawn from above that group except in certain cases. As the number of arrears is large, it is obvious that the arrears could not all have come from

the higher income groups. This the following figures of arrears as on 1-4-48 will demonstrate:—

	Category I.	Cat. II.	Cat. III	Cat. IV	Cat. V	Total
Arears of assessment .		44,575	65,092	1,06,718	1,32,650	3,85,700

The arrears in respect of salary assessments alone, in the Indian Union, as on 1st August 1948 are said to have been 91,636; and for refunds, there is usually a carry over of something between 16,000 and 20,000 each year. As the lower income group cannot present much difficulty in assessment, the conclusion is inescapable that the work expected of Income-tax Officers is in excess of what they are able to do. This excess may be partly composed of, as we have been often informed, work other than purely assessment work, *e.g.*, (a) representing the Department in appeals before the Appellate Assistant Commissioner, (b) preparation of briefs and second appeals for the use of the Departmental Representatives and (c) giving effect to reductions in appeal, etc. Some part of this excess is, we are informed, being remedied by reducing the number of returns and periodical reports expected of an Income-tax Officer or by transferring this work to others. Even with relief from clerical work, we do not think the Income-tax Officer will have time enough to deal satisfactorily with the amount of assessment work that is placed in his charge. Thus, if a Grade I Income -tax Officer is to do 185 assessments of Category I, it means that he has to do almost one assessment every two days including holidays, and it is common knowledge that most assessees in Category I have extensive businesses and a number of Branches. It is, therefore, almost cruel to expect an Income-tax Officer to cope single-handed (except for a clerk to do calculations) with 185 of such assessments in a year or over three assessments per week. The assistance of a personal clerk is not much of a help as intelligent correlation of accounts and skilful extraction of real features by examination of accounts requires considerable time in cases of the kind he is expected to deal with. If the amount of work is reduced, the number of Income-tax Officers would have to be increased to a very great extent, which may not be possible, if the standard of recruitment is to be kept high.

412. The other alternative, it seems to us, is to reintroduce the system of Examiners or something like it. The Examiner's cadre was discontinued on the grounds, among others, (i) that it induced among the Income-tax Officers lethargy, which made them dependent on the Examiners or there was duplication of work and (ii) that the Examiners, being low paid subordinates, were amenable to influences. On the other hand, it has been argued, particularly by Khan Bahadur Vachha, who has had a very long experience of the working of this system in Bombay, that by interposing two persons between the assessee and his assessment, the chances of corruption were reduced and that specialisation in accounts made the scrutiny more accurate than now. We agree that there is not much advantage in having Examiners employed on small cases; but in big cases and complicated cases, the continuous strain that the examination of accounts involves on an Income-tax Officer, if he is himself to examine accounts in all aspects and to apply test checks, is so great that the strain might prevent his discovering the whole truth. A clerk, who is only a mechanical assistant, can hardly remove the strain. A person like an Examiner of Accounts would in such cases be able to take part of the strain off the Income-tax Officer. We agree, however, that he should not be allowed to do more than bring together the raw material, which the Income-tax Officer alone should put into shape. We would suggest that, in place of the Examiners of the old regime, a new type of Gazetted Officers to be styled as Assistant

Income-tax Officers may be appointed and the necessary amendment authorising such appointment be made in the Income-tax Act. As the class of officers will, in addition to their status, have a good career before them, they may be relied upon to possess both ability and integrity. In the past, an Income-tax Officer was given so much assessment work (nearly 2,000 assessment cases in a year) that he had perforce to rely on the Examiner; but, if the distribution is somewhat as low as at present, he should be able to devote more time to the scrutiny of accounts; there will be no duplication as the new officers, we have suggested, will do only spade work; and there will be less chance of corruption, as they will be selected from a class not very different from the Income-tax Officers, and, secondly, their work will be checked by the Income-tax Officers. In addition to this specially recruited class of Assistant Income-tax Officers, there should be available others for examination of accounts even under the present system, *viz.*, the probationary Income-tax Officers, during their period of training and Leave Reserve of Officers, which even on the 10 per cent. basis should be a fairly good number.

413. These and other proposals, which we have made, may no doubt increase the cost of collection. The consideration of economy by all canons of good government is overridden by the needs of efficiency and of eliminating the evader. In the words of Schultz "American Public Finance", 3rd Edition, page 314:

"A low ratio of costs does not necessarily indicate an efficient tax administration. A tax office that makes no attempt to discover avoidance or check evasion, that contents itself with accepting such revenue as is voluntarily paid in, will of course show a very low ratio of costs to revenue. Another office that genuinely seeks to collect the full amount of taxes payable under the law, that seriously audits returns and makes sample checks, that provides review machinery necessitated by its more intensive improvement of the law, will collect much more revenue, but it will have a higher ratio of administrative costs. Low tax costs resulting from administrative indifference are as much an indication of injury to the tax-paying public as high costs resulting from inefficiency."

According to Schultz, the administrative and field personnel of the Bureau of Internal Revenue in the U.S.A. in June 1920 was 20,159, which included also the personnel for Customs, Excise, Corporation Tax and Personal Income-tax personnel. The number is much larger now. In the U.K., we were informed, the number of Inspectors of Taxes before the war was in the neighbourhood of 1700. The number of Income-tax Officers in the Indian Union is 729. Even after making full allowance for the larger tax revenue in the other countries, we think there is a need for increase of Income-tax administrative personnel in this country. An expensive machinery that plugs all loopholes is preferable to another which costs less but does not stop the leakage.

414. As regards the proposals for recruitment, it may be said that the larger the number of recruits required, the lower will the Department have to descend the steps in the ladder of ability, to recruit its quota of officers and this deterioration in the quality of its recruits might perpetuate the evil of inefficiency. Measures may be taken to reduce the load of annual work expected of the personnel of the Department, that is, firstly, by reducing the extra work *viz.*, interviews, etc. and, secondly, by reducing the number of files on which intensive work is to be done in every financial year. The present Form of Return, although comprehensive in most respects, might, we think, be improved to incorporate such further information as will help the officer to arrive at the assessable income without interview at least for certain categories

of income. For instance:—

(a) the address of the assessee should be both residential and official, the former for verification from the survey records,

(b) for purely salaried persons, information may be required in the Returns of (i) the name or names of the employer or employees as in certain industries, owned by a group of industrialists, an employee is paid from more than one business, (ii) the amount of salary to the employee due from each such employer and (iii) the tax deducted,

(c) from owners of Government Securities, who claim refund of tax, (i) description of securities, (ii) face value of securities, (iii) income received, (iv) tax deducted, (v) where tax is not deducted or is deducted at lower than the maximum rate, the description of the authority under which this is done, (vi) the interest paid on loan, the amount of the loan and the rate of the interest,

(d) In the case of professions:

Statement of Accounts showing gross receipts.	Expenses (with descriptive details).	Net income.

(e) In the case of Business, in addition to information already furnished, the following:—

A copy of the Trading Account with details as regards sales and purchases of each commodity dealt with both in money value and in quantities.	Name or Names of Banks in which the assessee has current and fixed deposit accounts with the name in which the account is maintained and the address.	A list of books of accounts maintained.

(f) In the case of *other sources*, details of dividends, details showing the names and addresses of persons from whom royalty, ground rent and other similar receipts are received.

(g) To save the time of the Income-tax Officer in hunting out facts from the records, the assessment records should be so arranged and made up as to include an index of all the peculiarities about the assessee's assessments in past years as well as the information collected for the year under assessment. This can be done by the clerical assistant or by the Inspector.

(h) Instead of trying to do every one of the cases. very minutely each year, the cases may be further arranged into two or three groups according to convenience and only one of these groups should be taken up for detailed scrutiny and examination each year. The other should be taken in the subsequent year, or years, so as to cover the whole field in two or three years. With the recent amendment of Section 34 of the Act, this procedure is not likely to present difficulties in covering up escaped income from groups set apart for later scrutiny; while the staggering method will increase the capacity of each Income-tax Officer and will thereby reduce the net number of officers required for the total work. Such methods are not unknown in other countries. According to Schultz, only about 7 per cent. of the millions of the personal tax returns submitted to the Internal Revenue Bureau in U. S. A. are carefully examined by the Federal Income-tax Branch in U. S. A. every year. The rest are accepted after a general scrutiny and are left over for a sample check.

415. With such arrangement of work and of the materials in the Returns and the records before him, the Income-tax Officer should be able to dispense with a large number of interviews, which take up so much of his time and the time of the public at present. It would reduce his labours further, if he were to insist on every accountant, who files his power of attorney for an assessee putting in his duly certified copy of statement of accounts for income-tax and if the public and the accountants could be made to feel that in the matter of convenience and interviews, such accountants as prepare their statements of accounts accurately receive greater consideration from the

Income-tax Officer than others. In this way, a general improvement will result in the quality of such statements, which will further save the Income-tax Officer's time and labour in examining accounts. If Accountants are taken into confidence and assessments are agreed to with them, more particularly for the years in which the scrutiny of the accounts is superficial under the staggering system, the occasions to reopen such cases under section 34 will also be fewer.

416. It has been suggested to us by some that Income-tax Officers should be instructed to take up large income cases in hand first. What was probably meant to be implied in this suggestion was that, owing to the imposition of the disposal diary, Income-tax Officers are inclined to fill up the prescribed outturn by small cases and postpone completing big ones, with the consequence that when the year nears its end, all the big cases are hurried through for revenue. The Departmental Officers have, however, another story to tell. It has been complained by them that big assessees are generally the worst offenders against regularity in filing their Returns of Income. Usually, they have to be coaxed into putting in their accounts. Whatever be the truth, we thing that he Income-tax Officer, as soon as the statutory period for receiving Returns of Income is over, should make out a programme of work for the whole year. In this he should space out all the big cases evenly throughout the year and follow the programme rigidly. If an assessee scheduled for the early part fails to respond, he should be dealt with as a defaulter unless he shows good cause. In order that no favouritism should be ascribed to him, the Income-tax Officer may change the order of priority from year to year. We are confident that if the Income-tax Officer shows by firmness and tact that, while he is willing to meet all reasonable requests, he is not prepared to grant unjustified postponements, the response to regularity will be better and the uneven pressure of work will be greatly reduced.

417. One of the items on the time-table of an Income-tax Officer in the present set up is what are known ss "Trial Cases". These are cases on the border-line where assessibility is uncertain and has to be tested either from accounts if maintained or from further inquiries. If an Income-tax Officer in charge of an assessment circle is also to do these 'trial cases' as he does at present, he will not be able to pay full attention to other important duties, as the procedural work involved in trial cases is only slightly less, if at all, than in regular assessment cases. In most trial cases, accounts are either incomplete or inadequate and the assessee is not accustomed to requirements under the Income-tax Act. The labour in arriving at the quantum for assessment is, therefore, greater generally and, in some cases, it has to be further supplemented by inquiries by the Inspector. It would, we think, conduce to speed, if these cases are dealt with in the first instance by the surveying staff itself, by whom the names are suggested and that staff might pass on their conclusions to the regular Income-tax Officer of the area for action, if convinced that, on facts recorded, an assessment can be sustained. This will reduce the Income-tax Officer's work. The surveying staff must, to be able to take on this work, include one or two Income-tax Officers, who will also supervise the work of the Inspectors under them. The class of Assistant Income-tax Officers whom we have suggested may also be utilised in this connection. Where after interviews and inquiry, a trial case is found not to have an assessable income, the record of the investigation should not be destroyed, but should be indexed and filed, for further reference, and a note should be made in the Survey Register of the proceedings taken. Such records will, we believe, save much of the time which Inspectors now devote year after year to the investigation of Intimation Slips.

418. Mr. P. C. Malhotra of the Income-tax Appellate Tribunal would extend such a system with some variations to regular assessment cases also. He

suggests that the Surveying Officer should issue regular notices under Section 22(2), collect the Returns, make inquiries and put up a report of assessable income to the assessing Officer. The latter will then have the two sides before him, that of the Surveyor and of the assessee and, as he is not a party in the collection of either material, he will be able to bring an unbiased mind on the assessment. Mr. Malhotra further suggests that the Surveying Officer as well as the assessee should have the right of appeal against the assessment made by the assessing Officer. This suggestion has certainly the merit claimed for it, of reducing favouritism, by providing a double check on the collection of materials on record and of ensuring a fairer approach to the assessee's point of view than obtains at present. On the other hand, the method differs only a little from the former system of employing Examiners, which we have discussed elsewhere. If both the Surveying Officer and the assessing Officer are to deal with the same cases, there will be duplication of work in all these cases. We have found that nearly 60 per cent of the assessment cases before Income-tax Officers are cases of small incomes. To provide two Officers on such cases would be uneconomical and the advantage secured may not be commensurate with the double labour and time that the system involves. In the present conditions, when the recruitment machinery is unable to provide even the normal strength of staff required to clear up the load of arrears, when recruitment of the right type is still difficult, when speed is the first consideration, and economy the second, the proposal does not appear to be expedient.

419. **Inspectors and Survery work.**—As the Royal Commission on the Income-tax, 1920, pointed out, the problem of evasion is "inseparable from a system under which the primary basis for the assessment of profits is the tax-payer's own return" (paragraph 629), "Although a tax-payer is obliged by law to make a return of his income, in many cases that return is, in the nature of things, capable of only a partial or imperfect check, and when this is known to or suspected by the tax-payer he is tempted to speculate on the chance of escaping detection if the return is inaccurate. He may not always be guilty of fraud; he may be culpably careless; he may decide every doubtful point in his own favour by deliberately refraining from inquiry; he may cultivate a profitable ignorance or a negligence that is not free from guile" (paragraph 625). Inspection of the books of accounts is the principal method of checking the correctness of the Return made by an assessee; such inspection, however, cannot disclose, in the nature of things, incomes, which, through either carelessness or by design, are withheld from the books. It is necessary, therefore, to evolve a machinery that will assist the Income-tax Officer in arriving at a quick decision on the reliability of the accounts placed before him. Towards this end, the Income-tax Department has always sought to collect materials from outside sources to check statements made by assessees. This collection of materials or information was previously made through Inspectors. It was the duty of the Inspectors to collect specific information about individual assessees in order to check the statements made by them, to report on new assessees, to survey the localities and put up estimates of incomes of the people in those localities for the information of Income-tax Officers, and conduct such other inquiries as they might be directed to make by the Income-tax Officers under whom they worked. The Inspectors used sometimes, especially in Circles to which Examiners were not appointed, also to assist the Income-tax Officers in the examination of account books produced by assessees. If time permitted, the Inspectors used to collect general information of assessment value from Public and Government records. The following extract from the administration Report of the Central Board of Revenue for 1931—32 gives an idea of what was aimed at:—

> "Lists are prepared at the beginning of the year from the registers kept at the Railway stations containing the names of the consignors and

consignees of merchandise. Extracts are taken from the books of wholesale dealers when examining their accounts. The registers of Registration Offices, Municipalities, District Boards and Civil Courts are also examined and details of decrees and of mortgage transactions are noted. The High Court Cause Lists and the accounts of all zamindars engaged in litigation are consulted for information as to the engagements of lawyers. All Government Departments and Local Bodies regularly supply lists of payments made to contractors and these are communicated to the Income-tax Officers concerned for use in checking accounts. Lists of contractors receiving payments from companies and mercantile firms are also prepared and passed on to the Income-tax Officers concerned. Lists of Barristers and Advocates prepared by the Bar Council are supplied and the lists of medical practitioners are obtained from the Secretary of the Medical Registration Board. A list of the motor owners is also obtained from the Police Department. Stamp Vendors' registers are also examined for deeeds executed by money-lenders"

Not all the items mentioned in this enumeration were actually attempted in all the Provinces, at any time, and, when the World War broke out, even the pretence of making inquiry on the scale proposed was given up. The better class of Inspectors were promoted as Income-tax Officers and those who were left and the new recruits had their hands full with "Intimation Slips", with the result that other inquiries were held in abeyance by the pressure of events

420. In the present organisation, Inspectors are divided into two groups: one group consists of men who are attached to Income-tax Offices, where they are entrusted with the duty of making specific inquiries about individual assessees, and also of making a survey of localities. The other group forms part of an Investigation Branch, which works under the supervision of an Inspecting Assistant Commissioner and is controlled by the Commissioner of Income-tax. The strength of the Inspectorial staff attached to an Income-tax Office is fixed on an *ad hoc* basis, and generally does not exceed 1/3rd of the total strength of Income-tax Officers, both permanent and temporary (additional) employed in other than purely salary and refund circles, for which no Inspectors are sanctioned. As the spearhead for local investigations, the Inspector attached to an Income-tax Office has to know all the principal business details for his area; he has to know not only his assessees but also others, who are not borne on the assessment list and he has to keep himself informed also of the social and other activities of the assessees as a check on their ability to spend on those activities; and all this he has to achieve without being conspicuous or inquisitive enough to attract attention. "Intimation Slips" which take up most of the time of the local Inspectors at present, will be less of a problem than they are at present if the Inspector knows his charge thoroughly; other inquiries into incomes and activities of persons within the area will not also take much time, if the Inspector has with him a detailed list of persons who own big properties, who conduct business or have other taxable income. This information is collected through what is departmentally known as "Survey".

421. Survey work used to be given priority in an Inspector's programme of work in the past and in Bombay and Calcutta a Superintendent of Survey with gazetted rank was specially appointed to supervise and to conduct surveys of business and residential localities in the City. In course of time, this part of the Inspector's duties appears to have been neglected, which, we think, was unfortunate. If a proper survey had been taken in hand during the period of the war of all localities at least in the principal towns and survey sheets had been prepared showing for each house, the names of the owner and of the tenants, a lot of evasion practised through disguised names, spurious addresses

and camouflaged businesses, would have been prevented, as Income-tax Officers would have been able to probe the disguises even while they were being paraded. Evasion by new assessees would have become more difficult and evoidance of tax by migration would have been discovered in time to prevent it. We were told by one Inspecting Assistant Commissioner in Bombay City that when in 1943-44 an intensive survey was made of even one locality, namely, 'A' Ward, as many as 2,500 new assessees were discovered and the total-revenue in one year from these assessees exceeded Rs. 5 lakhs. We, therefore, think that survey work should be given first place in the programme of Inspectors and to expedite the completion of surveys in the principal towns and cities, Government should increase the staff given to the Income-tax Officers for survey and inquiries. The sanctioned strength of Inspectors which according to our information was 230 on 1st June 1948 for the whole of India as against the sanctioned strength of Income-tax Officers of all grades of 729, is patently insufficient for a full survey, but may not be insufficient to maintain up-to-date the survey records once made up. For the initial survey a larger staff would be necessary, which will be reinforced by the probationary officers under training. It will, we think, repay its cost and labour by the reduction in the number of inquiries and consequent savings on Inspectors on that job, by bringing under tax the assessees who have been escaping so far, by enabling the Department to know its real strength and its potentiality and, from such knowledge, to avoid waste of man-power.

422. Inquiries made for the purpose of checking returned incomes, or statements made, or accounts produced, by assessees, are, by the nature of things, made for years to which the assessments relate. Therefore, in a good many cases, they are made many years after the events took place. Often, therefore, such retrospective inquiries have proved unconvincing or have reached results too late to be useful in assessments. If the Inspectorial staff, whether attached to Income-tax Offices or to the Investigation Branch could collect and record information concurrently with the events, the collection will be more accurate, fuller and more fruitful of results. We would, therefore, suggest that Inspectors should, in the course of their duties, be authorised and instructed to collect and tabulate current information relative to or likely to be useful for assessment purposes, from newspapers, from business deals, from court proceedings, even from gossip, without waiting till the commencement of the assessment for which such information may have to be used.

423. **Investigation Branch.**—Inspectors attached to the Investigation Branch have also a large and extensive sphere to cover. This branch, under the present name dates from 1946. It is placed under the control of the Commissioner in each Province. Allied to the Investigation Branch is the Collation Branch, which is under the direct charge of the Director of Inspection. It receives from various offices and Departments, intimates of payments, which it collects and distributes among assessing officers. The office of the Collation Branch is at Locksley Hall, Madras. The present sanctioned strength of the Investigation staff is:

	Actually employed Sanctioned strength	
	Grade II Officers	Grade III Officers.
Income-tax Officers,	7	4
Inspectors .	67	37
U.D. Clerks	22	35
L.D. Clerks	70	25

The sanctioned staff for the Collation Branch at Madras is 68, but the number actually working at present under the control of the Assistant Director of

Inspection is:—

19 Clerks for Ledgering.
3 on Receipts Section.
4 on Indexing.
3 acknowledgement slips
2 establishments.
2 on 19A Statements.

33 Total.

424. The province of the Investigation Branch is not only to collect information against evaders wherever possible but more especially to collect and collate that kind of information which will make people desist from making attempts at evasion. With this end in view, the Branch has to spread its net wide and to try to bring within it all that is floating about, although all of it may not prove of value. Provided, the information has assessment value, the Investigation Branch has to collect it, whatever be the sources that yield it. The information has then to be sorted out, sifted, tabulated and then distributed to proper quarters. Mr. Sundaram, who has made some helpful contributions on this subject, suggests that the information to be collected by the Investigation Branches of the Income-tax Department, should be recorded at three levels, namely, (a) the assessment files in the Income-tax Office, (b) in the Commissioner's office where a Special Bureau should be opened for this purpose and (c) in the office of the Central Board of Revenue where also a Special Bureau should be opened. For the purpose of this classification, he would lay down the following limits of income:—

Rs. 5,000 to Rs. 50,000 in the case of the Commissioner's Bureau and above that limit in the Special Intelligence Bureau with the Central Board of Revenue. Many others, while in general agreement with the proposal to establish an Investigation Branch, doubt its utility so long as the Department is unable to ensure a proper use of the information collected by the Branch. One of the replies mentioned specially the Returns under Section 19A and Section 20A and stated that the valuable information already available through these Returns is not being utilised by the Department properly. Much of this criticism is, no doubt, substantially correct. It is on the other hand equally true that recent events have so conspired that the Department has not had sufficient time nor the strength to give the Investigation Branch a fair trial. The Commissioners, overwhelmed as they are with heavy arrears in assessments and with a paucity of staff to attend to them, have neither the time nor the means to build up a Branch, which can show results only in the future. Perhaps also the Department having found the problem of investigation on the scale contemplated, vaster than anticipated, got frightened by the financial implications. We think, however, there is considerable potentiality of revenue in the collection of commercial and business information, interpretation of it in terms of assessments and distribution of it to proper quarters, and that if the two Branches of Investigation and Collation are properly worked, they will, by detecting actual omissions and frauds, as well as by preventing many more, benefit the revenue many times over the expenditure incurred. Prices change; speculations alter the fortunes of persons; properties change hands or are newly constructed; new capital is raised and new industries are started; contracts are entered into over the length and breadth of the land. All this information must be collected and collated, to check up the Returns which may be submitted and to bring to book those who may not submit to their proper liability under the Income-tax Act.

425. With Mr. Sundaram, we believe, that the Investigation machinery should work at provincial as well as central level. As at present, the provincial machinery should continue to work under the control of the Commissioner and the central machinery should be directed and controlled by the Director of Inspection, by whatever name he may be called. In England, the Investigation or Inquiry Branch is centrally administered. It works constantly, collecting, sifting, testing the information received and we were informed that evasions that have been discovered through its efforts in the U.K. have contributed no inconsiderable amounts to the Exchequer. The Commissioner's establishment should be able to collect information under the following heads:—

(i) Information from returns under Sections 19A and 20A;

(ii) Information regarding sales, purchases and mortgages from the offices of Sub-Registrars and Registrars;

(iii) Decrees for debts, etc. from civil courts;

(iv) Holders of shares from the registers of the Registrars of Companies;

(v) Lists of names of stock brokers, cotton brokers, bullion brokers and commodity brokers and their sub-brokers, from their association records;

(vi) Changes in ownership of houses and lands from Municipal records;

(vii) Contract payments by Railways, Public Works and Provincial Supply Department;

(viii) Important details of imports and exports from Customs Houses and Port Trusts;

(ix) Movement of goods through Railway records, municipal octroi and terminal posts;

(x) Description of new businesses from provincial sales tax records and the extent of the old and new businesses;

(xi) Lists of Directors and shareholders in Companies from the records of the Registrars of Companies;

(xii) Disposals of surplus goods and big sales through auctioneers;

(xiii) Lists of import and export licences from licensing authorities;

(xiv) Lists of big payments by book makers on the racecourse;

(xv) Details about prosecutions by anti-corruption Department and by Provincial authorities for breaches of control regulations;

(xvi) Large payments by stock brokers;

(xvii) Large amounts of over Rs. 25,000 each of purchases of bullion and of jewellery and other expensive and luxury articles; and

(xix) Membership of expensive clubs.

Such of this material as is not of purely local interest should be sent by the Commissioner to the Director of Inspection for being collated and distributed by his organisation. The central machinery will collect similar information for the central and headquarters establishments of the Departments mentioned previously and from the Defence Department, from the External Affairs Department, Department of Works, Mines and Power, Controller of Capital Issues, Controllers of Imports and Exports, etc. It should collect information about price changes in different principal commodities, about control regulations, details of licences issued, Disposals Department sales, etc. From this material and that received from the Provincial Commissioners, the office of the Director should circulate summaries and statements which can be used for the purpose of and in the course of, assessments. The Income-tax Officer, on

receipt of this information, from the Provincial and Central Investigation Branches, should have it recorded serially in the proper assessment records and an index should be prominently placed in that record of all the intimations received for each assessment year, which index should be checked and initialled by the Superintendent. The present method of filing intimation slips leaves a great deal to the honesty and industry of the clerk for bringing the intimations on record. An index card when checked and compared with the Receipt Register should afford some check on oversight or deliberate suppression. Such checks should be enforced in all offices through the Superintendents, and, if Inspecting Assistant Commissioners also make it a part of their duty periodically to inspect the index cards, the practical usefulness of investigation will, we think, be greatly enhanced. With the expansion of the machinery of Investigation, that for Collation must also expand, if the collected material is reach proper quarters in digestible form. The Collation Branch should be er strengthened by a machinery to keep a track of its intimations until satisfactory proof is obtained by it that the intimations and statements forwarded by it have been properly considered and utilised by the officers to whom they were sent.

426. To enable the Inspectors to discharge the difficult duties, which we have recommended, effectively and with as little conflict as possible with the public, they and other subordinate officers, *e.g.*, Assistant Income-tax Officers, etc., will have to be given:—

(i) a recognition under the Income-tax Act, and

(ii) certain powers.

The former can be achieved by adding in sub-section (3) of section 5, the following words after 'thinks fit', "and such subordinate staff as may be deemed necessary to assist the Income-tax authorities in the performance of their duties". The powers to be given will depend on the nature of their duties and will be restricted to statutory authority to take statements, etc.

427. It may seem that the steps above recommended cover such a vast field that it will be impracticable to give effect to them. We, however, feel that the difficulty is not so great as may appear at the first blush. In principle, the proposals are merely an extension of the methods of the present administration and once the system and the required machinery are brought into operation, the further task of merely keeping them upto date will be relatively light.

428. **Bailiffs.**—Khan Bahadur Vachha has brought it to our notice that under the recent orders of Government the cadre of Bailiffs has been abolished and simultaneously the arrears of tax collections have gone on increasing. We have not had time to obtain figures to see what extent the abolition of the cadre of Bailiffs has contributed to the accumulation of arrears of revenue. We, however, agree that it would conduce to quicker collections if appropriate and adequate machinery for the purpose is maintained.

429. **Ministerial Staff.**—The Ministerial staff in the Income-tax Department has difficult and complicated duties to perform. The notices, although most of them are printed, have to be correctly issued and have to be carefully worded by omitting unnecessary words, as a wrong word can change the whole aspect of an assessment. The calculations of tax and of refund are long and are often involved. They have to be accurately and quickly made, mostly without the help of Adding Machines and other similar aids, which commercial establishments maintain for their smaller staff. Many of the replies received have, therefore, suggested that greater care should be taken in the recruitment and training of the ministerial staff of the Department. The Bengal Chamber of Commerce have as usual expressed strong views on this point.

They say in their reply that "there is as much need for increasing the number of the clerical staff and for greater call for improvement in the type and qualifications of such staff. Experience in Calcutta—and it is not thought that this is an exception—demonstrates forcibly that the level of clerical staff is extremely poor for which there can exist no reason other than faulty selection and want of training and adequate supervision, defects, which, in these grades, should be capable of ready solution." An untrained and inefficient clerk is, they urge, a greater danger to revenue in this Department than in any other. To the extent that he is an efficient and willing worker, a clerk will relieve the Income-tax Officer of a part of his responsibility and contribute to the speed of assessment. It is an instructive commentary on the scales of pay offered to the clerks, their prospects and the nature of their duties, that very few graduates are willing to take service in this Department. It is, therefore, necessary, we think, to liberalise the conditions of work by planning it properly so as not to put too much strain on the Clerks, and to train the staff in their duties so as to make it easier for them to get used to their peculiarities. We understand that in some Provinces, examinations were held and some training was given to new recruits. The system should be extended and made a regular feature throughout the Department, if it is not so already. It is a regular feature in the Departments in the U.K. and elsewhere.

Equipment

430. Among the many handicaps under which an Income-tax Officer has to work and which hamper the progress and even the quality of his work, is the paucity of equipment. It does not appear to have been sufficiently recognised that even as a currency note cannot be printed without paper, an Income-tax Demand cannot be made without paper. An Income-tax Officer has to write to assessees and reply to a number of letters from them each day and throughout the year; he has to write out voluminous notes about the examination of the accounts of assessees as also assessment orders; he has to supply copies of such orders for various purposes; he has to send reports and returns to appellate and administrative superiors for statistical purposes. With the increase in the number of assessees, this work is daily increasing; and yet an Income-tax Officer's office is placed, for the grant of stationery, on practically the same level as other Departments of the Government of India, with a quota of Rs. 10 per year per clerk. We have already noticed that in 1939 the clock of assessment work was set back by about six months owing to the inability of Government to supply the forms of Returns of Income in time. Even as late as 1948, things were no better. In one Province at least the same deficiency with a similar consequence seems to have been experienced this year. In most Provinces, Refunds were delayed because Refund Order Books were not available. The work of the Authorised Officials of the Commission suffered similarly until recently for want of paper as the Commissioners in the Provinces had run out of their stock. We think it is false economy to stint the supply of paper to the Income-tax Department. Besides being adequate, the supply of paper to the Income-tax Department should be of more durable quality. As assessment records in Income-tax offices are to be retained in some instances for twenty years and in others for even longer periods, and as they are being constantly handled in the Income-tax offices, in the Appellate offices and in the Tribunal's offices, besides being sent often by post to the Central Government, the paper to be used for assessment orders, etc., must be both white and durable.

431. One of the severest but most useful critics of the equipment and management of affairs in an Income-tax office is the Bengal Chamber of

Commerce, who say:—

"Even in the most essential but elementary office requirements such as typewriters, etc., the Department is woefully deficient. Certainly mechanical aids and devices in a section where it is most needed are conspicuously absent and Comptometers and other modern machines, as an aid in rapid statistical calculations, do not seem yet to be realised as a need in the Department. The hours wasted in original calculations and their checking must be colossal. Office furniture as well as placement and location of the offices are in many instances entirely inadequate."

From what we have seen during our visits to the different centres in India, this criticism of the Bengal Chamber of Commerce does not appear to us to be exaggerated. Income-tax offices all over the country are mostly ill-equipped and over-crowded The officer usually works in a small cubicle with an area just large enough for a chair for the Income-tax Officer himself and a couple of more chairs for the assessees with one small table in between; where the rooms are larger the number of officers accommodated is also correspondingly greater. For library all that an Income-tax Officer gets is the Income-tax Manual, a set of Income-tax Reports, which also in most cases is shared between a number of officers, etc In matters of stationery, he is probably worse off, considering his requirements, than most Departments of Government. In respect of other requirements like typewriters, almirahs for arranging files, the story is equally sad. We found in each office stacks of assessment files spread out over the floor for lack of almirahs to place them in. It must be a matter of chance that assessment orders and acknowledgment slips do not get separated from their respective files and do not cause an embarrassment to Income-tax Officers by their absence from the proper places. There are other matters such as the lack of a stenographer, difficulties created by transfers, insufficiency of allowances for travelling and transport, which have been mentioned to us as contributing to discomfort and inconvenience of Income-tax Officers.

432. We have no reason to think that the unsatisfactory state of affairs with regard to either accommodation or equipment is due to deliberate action or want of action by Government. Residential and office accommodation as well as furniture seem to be equally a problem to the Income-tax administration in the United Kingdom to judge from certain reports that we noticed recently. In the United Kingdom, the problem seems to be handled with a sympathy and understanding, which has evoked helpful co-operation from the Service. Thus, transfers are avoided there as far as possible if residential accommodation for the person to be transferred is likely to be difficult. If the grievances of officers are treated here also with similar sympathy and understanding, and the officers are made to feel that their difficulties are being appreciated and looked into, we feel sure that the officers will accept their unavoidable discomfort with cheerfulness born of hope and that with mutual co-operation the period of adjustment can be made less difficult than it is otherwise likely to be. As soon as circumstances permit, we suggest that each Income-tax Officer should be given an independent room for office work of sufficient size, and that each Income-tax Officer should have also well-equipped waiting room for assessees. This matter of convenience of assessees who have to attend Income-tax offices and wait there some time has long been complained about, but with little effect. Among other conveniences, which are now scarce but are necessary, we should mention telephones of which each Income-tax Office should have at least two, one for the personal use of the officer and one for his office. This will be a great convenience to assessees also.

433. With regard, however, to the equipment proper and the help of stenographers, it is a matter that cannot be solved by sympathy and patience alone. As assessment orders cannot be got written by these virtues, the need for a stenographer must be met by giving a stenographer. Between, on the one hand, Appellate Officers. Inspecting Officers and assessees who want a detailed assessment order and, on the other hand, Commissioners and the Director of Inspection who wish cases to be disposed of in sufficient number, the Income-tax Officer is in a difficult position. His life will be much easier and his orders much more readable and informative if each Income tax Officer is given a stenographer to assist him and is not obliged to share a stenographer with another or other officers. Whether an assessment case is a big one or a small one, the necessity of dictating an order to ensure speed in disposal is the same. In the allocation of work, numbers make up for the difficulty or depth in the outturn expected of each Income-tax Officer. We see, therefore, no sufficient justification for making a distinction in the matter of stenographers. If they are not available for the pay offered, it is better that the pay should be increased than that the Income-tax Officer should be denied the convenience.

434. Allied to the question of stenographer is that of typewriters, adding machines and other mechanical aids, which relieve manual work, while also adding to accuracy and speed. The sooner the present scarcity of typewriters is removed, the better for the work of the Department, and if at least some of the principal officers can be supplied with other mechanical aids, considerable saving is likely to be effected in time and labour. Adding machines, accounting machines, addressing machines and Comptometers, particularly in heavy Circles, in Salary Circles and in Refund Circles, as also at the Head Office, will speed up work and assuage some of the public discontent; nor should furniture be allowed to lag behind.

435. In the matter of books, the Income-tax Officer at present is practically thrown upon the mercy of others. He is expected to meet lawyers on their own ground and accountants on their ground; and yet, to consult any book on law or on accounts, he has either to purchase a book or to borrow it from the same person with whom he has to argue. The former is beyond his purse and the latter is an unsatisfactory solution. Government should place at least in each multiple Income-tax office a small nucleus of a library consisting of a few standard books on Income-tax Law and a few on different methods of accounting and should circulate among Income-tax Officers one or two of such foreign periodicals on Income-tax Law and Procedure as are likely to assist them in their work and keep their knowledge of the subject up to date.

436. With regard to location of Income-tax offices, it has been suggested in some quarters that Income-tax offices might be distributed over different business localities for the convenience of the local assessees. On the other hand, it has been pointed out to us that such a distribution would make supervision difficult, and, even from the point of view of assessees, who are represented by accountants, auditors and lawyers, if all the offices are situated in one place, greater speed is possible than otherwise. We think, therefore, particularly as the question of accommodation is very difficult these days, that the present system of locating Income-tax offices as near as possible to one another, if not in the same place, need not be disturbed for the present.

437. In the matter of service convenience and facilities, we would recommend that, as Income-tax Officers have to move about in their jurisdictions for various reasons they should, as far as possible, be encouraged to maintain a

conveyance and, with this end in view, they should be granted conveyance allowances and other facilities in the matter of travelling allowances. These details, though small in themselves, have a cumulative value for the efficiency of Income-tax Officers and, by achieving greater facility and speed of work, reduce public discontent, which is one of the main breeding grounds for tax evasion.

Relations between the Department and the Public.

438. "To tax and to please, no more than to love and to be wise, is not given to man", so said Burke in 1774. The couple of centuries that have passed since then have only confirmed the truth of his words. In paragraph 329 of their Report, the Royal Commission on the Income-tax, in 1920, state: "Even good administration cannot prevent taxation from being to some extent unpopular with those who contribute to it, because taxation deprives the citizen of a portion of his means and devotes it to objects with which he may have little acquaintance and less sympathy, but an administration that is sympathetic and scrupulously fair, while adopting proper safeguards against evasion, can do much to reconcile the tax-payer to his lot and convince him that within the limits of the Statutes the tax has been laid upon him with due care and justice". While the Royal Commission found that in England "the Income-tax was successfully administered", the replies to our Questionnaire show the general belief to be otherwise in this country. The Indian administration does not appear to have achieved even a "passive acquiescence and a certain grudging co-operation on the part of the tax-payer", which is the minimum necessary to secure "the smooth working of the taxing machine so as to produce the full measure of revenue with the minimum of irritation to the tax-payer and with the least possible inequity between one tax-payer and another".

439. The complaints in the replies are, firstly, with regard to the personal behaviour of Income-tax Officers towards the assessees, secondly, as regards their official conduct, and, thirdly, against the system of administration under which they function. With regard to the first, the principal complaint is about the unpunctuality of the Income-tax Officers and their highhandedness. About official conduct, the objection is that the Income-tax Officers lack proper perspective, that they treat every assessee with undue suspicion and harshness "as if he was a thief and a robber", the onus being thrown on him to prove that he is otherwise, and that the assessments are partial to some and harsh to others. The objection against the administration is that the Income-tax Officers, although some of them are very efficient, and able, and men of excellent character, are not allowed to exercise their discretion properly with the result that the assessee carries away the impression that he is arguing against a wall.

440. A variety of suggestions have been made to cure this malaise. Messrs. Krishnaswamy and Jagannathan of Madras suggest that every member of the Department must be made to realise that he is a public servant, that he is expected to help the assessee, that he is not paid to harass the assessee, that he is expected to be kind, that he must show respect before he can expect respect, that he must presume that the assessee is an honest person till the contrary is proved, instead of starting with the presumption that the assessee is a knave until he exonerates himself, that under all circumstances he must keep up the dignity of his office irrespective of the behaviour of the assessee and that the virtue of punctuality is expected of him as he expects the same from the assessee. That there is another side to the picture and that it requires two to make a quarrel is ignored by these and other critics of the administration.

441. The adverse criticism of the Department, we think, has not a little

to do with the unpopularity of the levy. The tax collector is an heir to the antipathy inherent in every person to part with any of his income, which antipathy increases in the proportion the income is earned or unearned and the share taken by Government is large or small. In the Indian system, the position the Income-tax Officer holds is even more susceptible to such antipathies than elsewhere. He is both an investigating officer and a judge. To him are, therefore, directed the antipathies which an honest labourer feels in having to pay a share for an unknown benefit and of an evader towards a sleuth who tries to expose his action. At the present level of income taxation in India, where, above a certain level of income, what is left to the earner is only Rs. 3 in every Rs. 100, but the visual return for such a large sacrifice is small, the temptation is great to throw stones at the person who comes to collect the tax. Few of the tax-payers submerge it under their strong civic sense, some are kept on the path of rectitude by either respect for, or fear of, the law, others achieve a precarious equilibrium between their respect for the law and their love of money, while still others allow their cupidity to get the better of their civic sense, even fear of the law, and resort to evasion. The last named class is probably the most vociferous in their abuse of the tax-gatherer mainly by design, firstly, to throw off suspicion from themselves, and, secondly, to prevent public opinion from strengthening the hands of authority to combat evasion. Others join in mostly because of their sense of grievance against the tax.

442. In spite of this atmosphere of general hostility in which the Department has to work, it has to be said to its credit that it can show not a few instances of officers commanding genuine respect and confidence from the public in different parts of the country. "Honest, consistent and expeditious administration", says the writer on Public Finance in U. S. A. whom we have quoted previously, "will secure voluntary observance of tax laws from most tax-payers". This is equally true in India. The charge against the Indian administration, as a whole, is that it is neither honest, nor consistent, nor expeditious. When the present day honest tax-payer complains of the high incidence of the tax and is told that the level of taxation is high because the taxes are largely evaded, he naturally jumps to the conclusion that the tax collector is unjustly taking from him what is actually due from another and he attributes this process to the Income-tax Officer's incompetence, if not also to his dishonesty. He sees everywhere the hand of the tempter and every action of the Income-tax Officer is judged from this warped viewpoint.

443. The Income-tax Officer's first endeavour should be to remove such misconceptions from the public mind, if there be any, and to replace them by confidence in his fairness and judgment. Fortunately, the number of tax evaders is small as compared to the number of those who pay their dues properly in most Income-tax Circles. The Income-tax Officer has to address himself only to the majority, who being respecters of the law have only to be mollified for their loss by civility, courtesy and a "sweet reasonableness". This, the Income-tax Officer can do only if he moves among the assessees and studies their 'psychology twists'. He must, to start with, get rid of the complex, unfortunately still common among some of our young recruits that "the Officer" is superior to others. It is particularly unhelpful in the case of the Income-tax Officer whose dealings are all with the public. We have referred in paragraph 281 (under Refunds) to the instance where an assessee in the United Kingdom was pleasantly surprised to receive a Refund Order, without his asking for it. Such instances must multiply in India; the Income-tax Officer must show by his conduct that he is not the tax-grabber he is described to be but "a referee, standing between the State on the one hand and the tax-payer on the other, with the sole idea and desire that both get a square deal". It is only thus that he can carry the assessee with him and by sugarcoating the

pill of taxation make the assessee forget the bitterness of the tax-gatherer's duties or what is sometimes called the 'tax consciousness'. What is of paramount importance is that the assessee should be made to feel that he is not being singled out for unfair treatment, and once such a feeling spreads amon the tax-paying public, the relations between the Department and the public will improve automatically and with them will also improve the civic sense of the taxpayers. The evaders will be marked out, and will lose their ability to spread discontent and will find their occupation of evading a dangerous one.

444. We have been told that certain classes of advisers on Income-tax matters deliberately foster a spirit of discontent and fear among the taxpayers in order to feather their own nests. Perhaps, there is some truth in this complaint; perhaps the Income-tax Officer's actions and behaviour also give rise to the feeling of distrust in him. The remedy lies with the Income-tax Officer. If the Income-tax Officer sees to it that he is regular in attendance, prompt in attention, courteous in listening to grievances, however frivolous, in the manner of a skilful salesman, he will immediately find a big dividend in goodwill from the taxpayer to the discomfiture of the dishonest 'adviser'.

445. One of the criticisms most frequently found in the replies received by us is that the present system of training and administration does not leave the Income-tax Officer free to exercise his initiative and discretion. It is stated that the new recruits being yoked to duties before being fully broken to assessment work, approach their duties with diffidence which is only increased by the quality and multiplicity of inspections their work is subjected to. These make the young recruit apprehensive of exercising his better judgment. Whatever initiative is left to him after these set-backs to his judgment and discretion, is further depleted by the standard which is set to measure his efficiency. He is judged efficient not by the knowledge he shows or the manner in which he deals with the assessees, but the increase he makes in the demand of tax. His approach to assessment is thus not that of a fair judge but of a partisan collector of revenue. The Income-tax Officer and the assessee are thus ranged on opposite sides. Although the final word in this contest may rest with the Income-tax Officer, the assessee has the advantage of better knowledge, and, being a contestant, he thinks it a part of the game to beat down the Income-tax Officer with deceit, untruth and non-co-operation We have seen no evidence of any instructions to Income-tax Officers directing them to pitch up assessments; on the contrary, in the instructions in the old Manual, the Income-tax Officer was directed to be sympathetic towards the assessee, but the complaint is so widespread that we cannot ignore it as unfounded. We have no sympathy with an Income-tax Officer who surrenders his better judgment to the dictation of his superior; but we have still less sympathy for those who would use their powers under the Act without regard to justice, reason and fairplay. We have already expresed our disapproval of the Inspecting Assistant Commissioner who makes the Income-tax Officer a scapegoat for his views and thus saps the Income-tax Officer's discretion and judgment with his indiscriminate criticism. We would suggest that an Income-tax Officer should be judged not on the number of heavy assessments he makes but on the number of unsuccessful appeals against his assessments; on the knowledge and understanding he shows and not on the pitch to which he raises his assessments; on the speed of his collections and not on the size of his paper demands. There should be a firm adherence to the spirit of the law, which expects the tax-payer and the tax-gatherer alike to meet in a spirit of mutual trust.

446. Various other methods have been suggested to us to bring about a change of outlook, of conduct and of behaviour on the part of the allegedly

unsympathetic and tyrannical officer. Some propose that a Public Relations Officer should be appointed who should explain the ethics of taxation and the wrong that an evader does to his fellowmen in this country. A second proposal is that an Inquiry Officer should be attached to each Income-tax Circle where the small tax-payer can be helped to fill in his form of Return, etc. We found in some Provinces such officers actually functioning. There is this danger in assisting an assessee to fill in his form of Return, that the latter is apt to throw the blame for a false statement in the Return on the advice he received. If this can be avoided by insisting on the assessee himself filling in the form and attaching his statement to accompany the form, and if the Department can spare the services of an officer, who is experienced enough in Income-tax Law and Procedure to guide and to interpret difficulties correctly, we think that the labours of the Inquiry Officer will greatly simplify the work of the Income-tax Officer and that the assessee's grievances about the complexity of the tax system, which drive him to dangerous advice, will be greatly alleviated. Another proposal that is worth considering is that a Complaints Officer should be appointed to inquire into public complaints about delays and discourtesy on the part of the Establishment and that heavy punishment should be given and made known when given, for breaches of proper conduct on the part of Income-tax officials. This proposal is not new, and if it has not been tried before, it is due to the experience of other Departments where it has been tried and it was found that, more often than not, the complaints are used for blackmail or are frivolous and personal; the dangerous offender is astute enough to realise the danger of superior inquiry and will not himself consciously invite it. The very fact, however, of the existence of a machinery to listen to public complaints, if that machinery is attached to the Commissioner's office, is likely to prove a deterrent to improper conduct and we think that, on this ground, at least, the suggestion should be given a trial. The Complaints Officer should be of the rank of an Assistant Commissioner attached to the Commissioner's office, who will be capable and experienced enough to judge quickly between truth and untruth, who can take quick decisions, has no personal alignments, one who knows the Income-tax Act and Procedure thoroughly and who will have authority enough to enforce his views. If he looks into complaints and grievances of a general character only and tries to remove them, the machinery of administration will be shown up and ultimately weeded out.

447. Other remedies suggested are merely extensions of the present practice. It has been proposed that Commissioners and Assistant Commissioners should contact more freely and frequently assessees through Associations and also individually, that towards this end they should publish their tour programmes in advance of their actual visits, that complaints of an all-India character should be heard by the Member. Central Board of Revenue, and the Director of Inspection, who should for the purpose visit the Provinces more frequently and should maintain a more frequent contact with Provincial Chambers of Commerce and Merchant's Chambers. We have every sympathy with these suggestions.

448. While these and other similar methods might improve the official side of the shield, it is more difficult to achieve the same result in respect of the popular side. As the Royal Comission on the Income-tax, 1920, put it: "The citizen who is deficient in public spirit has always aimed at paying less than his fair share of the nation's expenses, and it is safe to assume that he will always continue to do so. This may be said of every tax, but it is especially true of the Income-tax because there are many cases where a knowledge of the

amount of the taxpayer's profit is confined to himself or shared only by his confidential employees or his professional advisers". In this country, where the means available to make large incomes are few owing to insufficient growth of industry and the number of rich men is consequently small, the glitter of large fortunes makes the public perhaps more tolerant to the dubious means employed in collecting those fortunes than elsewhere. The Bengal Chamber of Commerce say: "As things are at present, there is no question but that those who are known to be the biggest deliberate taxation cheaters are received in all ranks of society in the country and virtue of their very success in cheating, are surrounded by an aura of ability and shrewdness, instead of being ostracised and stamped with obloquy. There can be no public conscience in the matter of taxation as long as these conditions obtain". Some consider that to train the public conscience against evasion and to bring about helpful co-operation between the public and the administration for combating evasion is "like discovering the formula for transmuting metals into gold'. Others are, however, more optimistic of achieving results with the help of propaganda, more frequent contacts between the officers and the public, appointment of Public Relations Officers, liaison Officers, Press Publicity, Radio talks, etc. Another school of thought would make penalties more severe so as to be deterrent. The latter suggestion was made even before the Royal Commission on Income-tax in 1920 "by an experienced and eminent lawyer, who said 'people must be made to understand that if they defraud the Revenue, they are committing a mean and despicable offence against every one of their fellow tax-payers', an offence which he declared, should be punished by imprisonment, so that the offender "should be made to feel the ignominy and disgrace attaching to the crime he has committed"—Paragraph 644. While punishment may be some answer, it is never a complete answer to crime. In specialised types of crime like the evasion of taxes, it reaches mostly those who are unwary, inexperienced or unlucky. The more dangerous culprits, who are astute and able enough to cover up their traces effectively more often escape. Moreover, as we have already said elsewhere, penalties sometimes are apt to defeat their purpose by over-severity, while they are ineffective if lenient. To strike the golden mean is not always possible, owing to the fluctuating rates of tax. For a punishment to be deterrent, not only must it make the offender feel its pain but also its effect should be more than temporary. If the effect is temporary, the offender will easily return to his old wiles as soon as that effect is over. It is only when an offender is reminded of his loss and is put to inconvenience from time to time, either in the course of his business or in his contacts in the social circles he moves in that he will be dissuaded from yielding to temptation a second time. It is no doubt true that the whip of public conscience which lashes the evader into the straight path is still not so long nor so strong in this country as it is in England and in some other countries; but those countries had the advantage over us of many years of political freedom, which made the interests of Government and the public identical. Educated people in our country, who contributed so much to the dawn of our freedom, can contribute equally to the dawn of public conscience by their example and their actions. If, for instance, the Accountants can make it their creed not to assist an assessee, whom they suspect of trying to evade tax, or if the lawyers will refuse to give advice when it is sought for the purpose of tax evasion, the defrauder will be either thrown on his own resources of skill which cannot be large or be driven to inefficient advice, with the result that he will soon find it "a bad business". If Associations of business interests will refuse to elect to positions of trust or of honour persons who have been either penalised or prosecuted for evasion of taxes, no prominent businessman will venture to evade. In another connection (*vide* paragraph 236) we have recommended that, with proper safeguards, names of

be published. We are confident that a lead given by responsible business and professional interests will not be long in being followed by others, who even now have very little to gain from the evader and much to lose. We are also confident that a Government which is elected by the people will not fail to get a just response from Business, big as well as small and also from leaders of the different professions, and that aided by the co-operation and change of outlook and methods from the Department, for which we have already pleaded in the earlier part of this section, the tax evader will soon find the soil of this country unhelpful and unpropitious to him.

(Sd.) S. VARADACHARIAR,
29-12-48.

(Sd.) G. S. RAJADHYAKSHE
29-12-48.

(Sd.) V. D. MAZUMDAR,
29-12-48.

H. S. RAMASWAMY,
Secretary,
29-12-48.

SUMMARY OF RECOMMENDATIONS.

A.—Residents and Non-Residents.

Recommendation No.		Paragraph No.
1.	A radical change is both necessary and justified in the treatment by the Indian Income-tax Law of persons resident in the Indian States. Arrangements, legal or political, should be made so as to bring into the category of "residents" for the purpose of the Indian Income-tax law at least such of the residents of the Indian States as have business connections or sources of income in the Indian Union. So far as concerns the assessment of persons, who derive taxable income from both the Union territory and the State territory, and of Indian residents deriving taxable income from State territory, it must be arranged that the assessment may be made by the officers of the Indian Income-tax Department, subject to any arrangement between the Union and the State as to the division of the proceeds of the tax. The Assessing Officer should be able to exercise the same powers in the State as he has in the Indian Union for collecting information relevant to the assessment, and enjoy all the other facilities required to make those powers effective. As regards other categories of "non-residents", it may be necessary to consider in due course the justification for or propriety of continuing the discrimination made in favour of British subjects and the appropriate manner of dealing with residents of French and Portuguese Possessions in India and of Pakistan and Burma and Ceylon, who may have sources of income in India.	31
	We recommend that the special category of "not ordinarily resident" be omitted. The tests prescribed in Section 4-A are in many cases sufficient to exclude hardships consequent on the abolition of this category. If any still remain, they may be dealt with by appropriate changes in section 4-A(a) (ii).	36
	The abolition of the special provisions relating to persons "not ordinarily resident" may have the effect of imposing a tax liability on some categories of Indians now living abroad in respect of their foreign savings which they may bring with them when they come over to India for good. because some of them may fall within the terms of section 4(1) (b) (iii). Appropriate provision should be made to exempt such cases.	39
	In taxing non-residents in respect of their Indian income—	
	(1) their foreign income need not be taken into account at all, but the rate appropriate to their Indian income with a surcharge of 20 or 25 per cent. may be adopted; or	

Recommendation No. | Paragraph No.

(2) the non-resident may, if he thinks that even the inclusion of his foreign income will not attract as high a rate, be given the option of proving his foreign income to the satisfaction of the Assessing Officer and thus get his Indian income taxed at the appropriate rate. The option once exercised shall be final. 42

5. Sub-section (3) of section 42 has been so construed as to make the whole profits or gains on foreign goods sold in India taxable under the general language of section 4, sub-section (1), on the ground that the whole profit or gain accrues or arises at the place of sale. This was not the intention of the Ayers' Committee on whose recommendation the amended section was based. Even if the adoption of the view recommended by the Ayers' Committee is likely to prejudice the revenue, the matter should be directly presented to the Legislature for examination.

If our suggestion to abolish the category of persons "not ordinarily resident" is accepted, the reference to that category in section 42, sub-section (2) must be deleted. 43

6. A proper method of assessment requires that the income derived by the non-resident trader from his different businesses in different parts of the country and through different persons should be aggregated for purposes of assessment, and where recovery from the non-resident himself may not be easy, some provision must be made for the recovery of the full assessment from one responsible resident representative instead of its being recovered piecemeal from different representatives and from the assets lying in or profits made in different parts of the country. 44

The Department should have power to select one such person as the sole representative; the selection must be made only after notice to the non-resident trader, wherever possible, and after notice to the person proposed to be selected as the sole representative, and after hearing the objections, if any. Power should, therefore, be conferred upon the Income-tax authorities in clear terms to make such a selection. A provision similar to section 219 of the Australian Income-tax Act would serve this purpose. 45

The personal liability of the representative assessee as well as his right of retainer must be limited on the lines indicated in provisos 2 and 3 to section 42, sub-section (1). For the recovery of the balance of the tax, there is only the power under the first proviso to that sub-section and the best that can be done is to authorise the Department to freeze the assets in the hands of the other representatives till the assessed tax is paid up. 46

Recommendation No. | Paragraph No.

7. A company treated as 'resident' under the second part of Section 4A(c) should be allowed to set off foreign losses against the Indian Income only on condition that it agrees to bring into the account of Indian taxation at least a like sum out of its foreign income in the years in which its status may become non-resident by reason of its foreign income being greater than its Indian income. The question whether in any particular year it has made more than 50 per cent. of its income in India, must be decided independently of the foreign losses brought forward from the previous year. If the company desires to avail itself of the benefit of accumulated losses for 6 years, it must agree to bring into account its world income even if in the subsequent years it has become non-resident. Alternatively it may be provided that foreign losses can be set off only against foreign profits.

8. All companies should be asked to make a return to a Central organisation in respect of dividends paid to non-resident share-holders. The Central organisation shall determine the total dividends and issue instructions to the various companies to deduct super-tax at appropriate rates. Such Central organisation may be asked to deal with all matters relating to the taxation of non-residents and not merely with their dividend income. 51

9. If Recommendation No. 1 is not given effect to and the existing policy and arrangements continue, the losses incurred by the Indian resident in the State territory should be excluded in the computation of the total income just as the income arising or accruing in the State territory is excluded under section 14(2) (c). The proviso to sub-section (1) of section 24 has been misplaced. It seems best to treat the three provisions-section 14(2) (c), proviso (1) to section 24(1) and proviso (a) to section 24(2) as one group of allied provisions relating to a special category described as "income and loss in the Indian State" and enacting them as three sub-sections of an independent section, say section 24-C. As a precaution, the section may begin with the words "Notwithstanding anything contained in the other provisions of this Act..........". The language of proviso (a) to section 24(2) requires revision. 56

10. Save in exceptional circumstances, an obligation must be cast by law on a person intending to leave this country to give to the Income-tax authorities reasonably sufficient notice of his intention so to leave, and if the tax payable up to the date of departure is not assessed and paid before departure, the Income-tax Officer must have power to demand security for payment. There must, be some provision prescribing the consequences of the assessee's default either in giving information

Recommendation No. **Paragraph No.**

of his intended departure or in giving security for payment of the tax that may be found due. An obligation must be cast on the Income-tax authorities to complete the assessment as expeditiously as possible in such cases. In enacting provisions on the lines suggested, care must be taken so to word them that they will not cover tourists or casual visitors. 55

11. Special officers should be appointed to keep a watch on remittances sent abroad of profits made in India, and they must collect information from Exchange Banks and other Banks as to remittances to foreign countries and scrutinise them to see which of them are remittances in the ordinary course of trade and which are remittances of profits. 57

12. The wording of section 24-A should be so modified as to permit an emergency assessment being made from the last completed assessment in which the assessee was fully assessed. The defect in the wording of the section as it stands may be rectified by inserting the word "fully" between the words "last previous year of which the income has been" and "assessed in his hands" in sub-section (1). The words "fully assessed" in the second sentence of the sub-section should remain as they are. 58

B.—The Hindu Undivided Family.

13. The assessment of the Hindu undivided family as a unit is not only not inconsistent with but substantially agrees with the legal position under the Hindu Law. 64

14. The position even of brothers in an undivided Hindu family does not correspond to that of partners because the latter are entitled to specific shares in the partnership income and are entitled to an account in respect of the same. 65

15. Although there is great force in the argument of hardship in the assessment of the Hindu undivided family under the existing law, there is much to be said in favour of the view that the Hindu undivided family may continue to be treated as a special category by itself instead of being assimilated to an ordinary individual. 66

16. The most feasible method of granting relief seems to us to be to raise the limit of the non-taxable maximum both in respect of Income-tax and super-tax. The minimum concession should be that when an undivided family is assessed as a unit, the non-taxable maximum, both in respect of income-tax and super-tax, should be at least twice that prescribed for individual assessments.

17. Where, however, the undivided borthers are four or more than four, the non-taxable maximum for both income-tax and super-tax should be thrice that fixed for individual assessments. 69

Recommendation No.		Paragraph No.
18.	There was no justification for limiting the concession recommended by the 1936 Committee to cases where there are more than one *adult married male member* in the family. There was even less justification for the superadded condition that the individual incomes of all members (including wives and other minor children) from whatever source derived should be included in the income of the joint family for purposes of taxation on the concession basis.	70
19.	We are unable to entertain the suggestion that every adult male member of the family should be given abatement similar to earned income relief. It will be no easy task for the Income-tax Officer to determine which of the members are contributing by their labours to the taxable income of the family, and what is the extent or value of each member's contribution. As long as salary paid to a partner is not treated as an allowable deduction under the head of "Business expenditure", there is little justification for meting out a different treatment to special remuneration paid to a member of the Hindu undivided family for looking after the family business. The considerations which led the Legislature to supersede the previous case law relating to partners by the enactment of section 10(4)(b) are equally applicable to remuneration claimed by a member of a joint family for looking after the business of the family. We advise legislation on the lines of section 10(4) (b) even in respect of joint family members, except so far as interest on self-acquired or separate funds lent to the family may be concerned.	71
20.	A mere division in status of a Hindu family governed by the Mitakshara Law will only place such family in the same position as a Hindu undivided family governed by the Dayabhaga Law. Both can appropriately be assessed as units. A division by *metes and bounds* would be necessary before the family assessment can give place to individual assessment. Perhaps a real demand for division by *metes and bounds*, if not complied with by other members, may create circumstances justifying individual assessment of the sharer who makes such demand.	72 & 74

Section 14(1)—Effect of the decisions.

21.	It is doubtful whether the Privy Council decision in the Bhagwati case gives effect to the scheme or policy of the Income-tax law in so far as the decision dissociates the operation of section 14(1) from the question whether at the time when the payment, in respect of which exemption is claimed, was made, there was an undivided family which was assessed, or was capable of being assessed, as a unit.	78

Recommendation No.		Paragraph No.
22.	The true test must be whether the amount is paid in satisfaction of a claim *payable* out of the income belonging to the joint family. We, therefore, suggest that section 14(1) may be recast as follows:— "The tax shall not be payable by an assessee in respect of any sum which he receives as a member of a Hindu undivided family out of income in respect of which the family itself has been, or can be, assessed as a unit."	79
23.	Under the rulings of the Privy Council, the family assessment gives place to individual assessment where there is only one male surviving coparcener. In a Hindu family when the owner for the time being is assessed as an individual, the Privy Council have laid down in Dudhuria's case (1933 I.T.R. 135) that the proper course will be to deduct the maintenance charges payable by him before fixing the amount for which the individual could be assessed. If under these circumstances the maintenance amount will be liable to tax in the hands of the maintenance-holder, it will be hard on such maintenance-holder if his or her immunity from taxation is made to depend on the accident of the number of sharers in the family property remaining more than one or becoming reduced to one. The proper course will be to continue the exemption even after the assessment of the family has become an 'individual' assessment, and if the Government is not prepared to lose the tax on the maintenance amount, an express provision may be inserted in the Act excluding the application of the decision in the Dhuduria case to certain defined categories. This course will be fair at least in cases in which the maintenance amount was fixed at a time when the family was being assessed as a unit, because the amount would then have been fixed on the assumption that income-tax would be borne not by the recipient of the maintenance allowance but by those paying the allowance.	80
24.	So far as the income from impartible estates is concerned, it is the individual income of the proprietor and can be made the subject of only individual assessment. The above principles will apply to maintenance paid to the junior members of the family owning impartible zamindaris. The problem will be complicated by the fact that the person paying the maintenance may have both agricultural income and assessable income. Some kind of apportionment rule may be followed in determining how much of the maintenance amount can be deemed to have been paid out of the agricultural income and how much out of the assessable income.	81
25.	As we have recommended the abolition of the category of "not ordinarily resident", the double nagative process by which we have to frame the concept of "ordinarily resident"—because this expression is not as	

Recommendation No.		Paragraph No.
	such defined in the Act—is no longer called for and section 4-B(b), which lays down when a Hindu undivided family is deemed to be "ordinarily resident" in British India, may well be omitted.	82
26	Sub-section (1) of section 64 provides a rule of choice in respect of "Business, profession or vocation" carried on in more places than one. Where, however, the family has only other sources of income, sub-section (2) merely gives jurisdiction to the Income-tax Officer of the area "in which he resides". There must be some rule of choice provided for cases where such other sources lie in different areas, unless it is assumed that sub-section (3) is sufficient to meet su[illegible] cases.	83
	C.—Taxation of Companies.	
27.	The chances of public limited companies being formed for the purpose of avoiding tax are not many and their dividend policies are not likely to be greatly affected by consideration of the amount of tax which individual shareholders will have to pay. They will be seriously prejudiced if the companies are subjected to super-tax at a progressively increasing rate. If such super-tax is levied, it will not be fair to exclude application of section 49-B to such cases. The work of refund applications will be increased without any commensurate benefit to the revenue.	84
28.	While there is no need to interfere with the normal functioning of non-public companies or incorporated family partnerships, the state is entitled to step in when the legitimate use of the machinery of incorporation gradually gives place to a fictitious use for purposes of tax avoidance.	86
29.	When incomes are in the higher grades, charges by way of [illegible]poration tax, the loss of benefit relating to earned [illegible]me privileges, etc., will be found to be much lower than the taxes which should be levied if the income had been directly received by the individual, because the super-tax on individual [illegible]me in these grades is very high. Section 16(3) is easily evaded and the operation of section 23-A can to some extent be successfully checkmated.	87
	If some provision is made with a view to check such attempts, we do not think it necessary or wo[illegible] to recommend that non-public limited comp[illegible] be assimilated to partnerships. It may be le[illegible] cases to the discretion of the Inspecting Assistant Commissioner to exercise the power under section 23-A. A like discretion may be given to him to insist on full distribution (not merely 60 per cent) in cases in which one non-public limited company does no business of its own but merely receives dividends from another, because in such cases there is little necessity for the holding company to build up a reserve.	89

Recommendation No.		Paragraph No.
31.	Where 60 per cent of the profits of a non-public limited company has not been distributed and as a kind of penal consequence an order has to be made under section 23-A to the effect that the undistributed portion of the assessable income shall be deemed to have been distributed as dividend, it seems reasonable to provide that such notional distribution shall be subject to the provisions of section 277-K of the Companies Act. In the case of Banking Companies, some portion of the profit is compulsorily transferable to the Reserve Fund.	91
32.	Similarly, in determining the assessable income for the purpose of section 23-A, public charges like Municipal taxes, cesses, etc., which a company will be bound to pay, should be allowed as legitimate deductions though they may not be permissible deductions for purposes of assessment of income-tax.	91
33.	It is conceivable that, by reason of difference of opinion or in the method of calculation between the Assessing Officer and the company's officers, the amount distributed may prove to be less than 55 per cent insisted on by the second proviso to section 23-A. To meet such situation, the second proviso to section 23-A may be enlarged so as to include cases where the distribution actually made has fallen short of 60 per cent of the assessable income by reason of the Assessing Officer determining the assessable income to be greater than it was according to the calculation made by the company. If even after this relaxation some cases presenting special features arise, the Inspecting Assistant Commissioner should be given discretion to deal with such cases even though they strictly fall to be dealt under this section. It is desirable to indicate that the Inspecting Assistant Commissioner has some measure of discretion even when he finds that the conditions prescribed by the opening words of the sub-section exist. Sub-section (2) of this section provides that the Inspecting Assistant Commissioner shall not give his approval to the Income-tax Officer's proposed order until he has given the company concerned an opportunity of being heard. To this we would add a further provision to the effect that the Inspecting Assistant Commissioner may, for reasons to be recorded by him in writing, withhold his approval even when he finds, in agreement with the Income-tax Officer, that the conditions prescribed by the opening words of sub-section (1) exist.	92

Treating Salaries and Loans as Distribution of Dividends.

34.	If it is clear that the Income-tax Officer has power to determine the reasonableness of the amount paid as salary to Directors and other principal persons be-	

Recommendation No. | Paragraph No.

hind the company in relation to the services rendered, no difficulty arises. If the amount is paid to a dummy whose taxable income may not be large, the principal of the decision in Aspro's case (L.R. 1932 A.C. 638) will probably suffice to enable the Income-tax authorities to determine whether the payment represents genuine salary or not. 93

35. Presumably, even in the absence of a specific statutory provision on the point, the Revenue authorities have power to decide whether sums described as loans advanced by a non-public company to the controlling shareholders represent income liable to super-tax. But it would obviously be desirable to define the power clearly by a specific statutory provision. If loans should in certain circumstances be treated as distribution of dividends, they should be taken into account in the application of section 23-A. 94

36. If the shares in a non-public limited company allotted to any person whose name appears as that of a shareholder therein could be shown to have been assigned to him only as a benamidar for the promoter, it must be open to the Income-tax authorities to include the dividends paid on such shares as the income of the real owner. If the reasoning in the recent judgment of the Bombay High Court can be interpreted as precluding such a course, specific provision must be made in the Act to permit such inclusion. Where the incorporation itself can be shown to be a mere bind or pretence, *i.e.*, "without intention that it should in truth have any effect as defining the rights of the parties as between themselves", the view indicated by the Judicial Committee in Sundersingh Majithia's case as to a fictitious partnership should be equally available to enabled the authorities to ignore the alleged company. The judgment of the Court of Appeal in Sanson's case recognises the possibility of the conclusion that the business alleged to be carried on by the company was in truth the business of an individual. 95

D.—Partnerships.

37. So long as the practice of creating nominal intermediary concerns with a view to show a reduced profit for the principal concern subsists, Income-tax authorities must have power to go behind the document and determine the person or persons into whose pockets the profits of the nominal partnership have gone. It is, therefore, necessary to insist that the production of a deed of partnership should not automatically entitle the person producing it to have it registered by the Income-tax authorities and that registration should not preclude the authorities from going behind the document, if there arises ground for suspicion, and determining who has the real control over the income. 96

Recommendation No. | Paragraph No.

38. In order to prevent assessees making it appear that the profits of a good year really belonged not to one person but to a number of partners and, in support of this attempt, producing an ante-dated partnership deed or a deed reciting the commencement of the partnership at an earlier date, registration of the deed by the Income-tax authorities must be registration within a short interval, say three or at the highest six months, after the commencement of the alleged partnership. 98

39. We do not recommend provisions on the lines of sections 10 and 10-A of the Excess Profits Tax Act being inserted in the Income-tax Act, but we consider that powers of the kind referred to in paras. 95 and 96 (in respect of non-public limited companies and of partnerships) are necessary, and if there is any doubt as to the availability of such powers under the existing law, they must be specifically provided. 100

E.—Mutual Associations.

40. The recent decision of the Privy Council in English and Scottish Joint Co-operative Wholesale Society, Ltd. vs. Commissioner of Income-tax, Assam (1948), 2 M.L.J., p. 242, may call for a reconsideration of some of the Indian decisions and the Income-tax Department itself may have to reconsider certain questions in the light of the rationale of the Privy Council judgment. Beyond sounding a note of caution as to the results and implications of the Privy Council judgment, it will not be expedient to recommend any definite legislative provision at this stage. 101

41. The claim that under sub-section (6) of section 10 of the Act the *whole* expenditure of mutual associations should be allowed as a deduction from the taxable income, irrespective of a part of the income being non-taxable, is irreconcilable with the general scheme of the Act. It will be for Government to consider whether there is reason for extending to any particular category of mutual associations the principle applied to co-operative societies under which they can set off a deficit resulting from non-taxable activities against income subject to taxation. If any such are found special provision may be made for them. 102

F.—Life Insurance Companies.

42. The logic of the claim for the full exclusion of the bonus amount, before arriving at the taxable income of a life insurance company on the valuation surplus basis, is not altogether unassailable. 109

43. The bonus paid to participating policy holders really consists of two parts, and it may be described as partly return of the capital or premium and partly

Recommendation No.		Paragraph No.
	return *on* the capital. So long as the bonus amount was not less than twice the load, the 50-50 formula would have been quite justifiable both in theory and as a matter of fairness; but if the tendency for the bonus amount to approximate more and more to the load should persist, the claim that a greater proportion, if not the whole, of the bonus would really be in the nature of return of the excess premium, would be more and more justified.	110
44.	There is much to be said in favour of the claim that under the present conditions a much greater portion than 50 per cent. of the bonus paid to the policy-holders should be excluded when computing the taxable income of a life Insurance Company. The logic of the situation does not necessarily require the adoption of the English system under which the whole of the bonus amount is excluded from computation. Taking the principle to be that so much of the bonus as exceeds the load is in the nature of profit and taxable as such, the tax should be assessed on the aggregate of (i) the dividends paid or reserved for shareholders, and (ii) so much of the bonus allotted to or allocated for the policy-holders as is in excess of the sum representing the load provided for in the premia paid by the participating policy-holders. Another form in which the method may be defined is that the tax should be assessed on the total surplus (actuarial surplus and the tax deducted at source) *minus* the sum representing the load. The Central Board of Revenue and the Insurance Department may, in consultation with the Insurance Companies, find a more easily workable formula than the one stated above, giving effect to the principles above indicated.	111
45.	The existing law exempts from Income-tax insurance premia to the extent of 1/6th of a man's income or Rs. 6,000, whichever is lower. It will not be in the long-term interest of the public, especially of middle class people, to hold out a temptation to put by more than one-sixth of a man's income by way of insurance premia.	112
46.	Where assessment is made on the investment income basis, the claim that the entirety of the management expenses should be allowed as a deduction is theoretically justifiable. Care will, however, have to be taken to prevent big amounts being claimed as management charges. We recommend that, in Rule 2(d) of the Schedule to the Income-tax Act, the figure 15 be substituted for the figure 12. This will mean that as regards renewal premium the allowance for the expenses will be 15 per cent. of such premium instead of 12 per cent. as at present. The rest of the rule, *viz.*, that relating to 90 per cent. of the first year's premium where the premium-paying period of the policy is 12	

years or more and $7\frac{1}{2}$ per cent. of the first year's premium multiplied by the number of years for which premiums are payable where the premium-paying period is less than 12 years, will stand. 118

47. The fact of deduction at source cannot affect the legitimate method of calculating the surplus available for distribution, nor should it be allowed to nullify the effect of the rule which exempts one-half of the policy-holders' bonus from liability to tax. The present method of grossing up cannot be accepted as the proper method. 119

48. If the method adopted by the Actuary is not the correct method, it is only fair that we should indicate what in our opinion the correct method [Illustration (C) in paragraph 18] would be. 120

49. We are not prepared to recommend discontinuance of the practice of tax being deducted or recovered at source in the case of interest and dividends paid to Insurance Companies. But Government should allow them interest at 2 per cent. per annum on the amount by which the deduction at source (or in the case of dividends, the amount paid by the company concerned on behalf of the Insurance Company) may exceed the amount of tax actually levied on the Insurance Company. 121

50. There is no justification for discriminating in favour of Insurance Companies and reducing in their case the 5-anna rate of income-tax to 45 pies in a rupee. Even as it is, they do not pay Corporation tax; it is worth considering whether so much at least of the income of Life Insurance Companies as corresponds to the portion distributed amongst their shareholders should not be treated as standing on the same footing as profits made by any other company with the consequent liability to bear the two annas corporation tax. 122

Mutual Insurance Associations.

51. In view of the decision of the House of Lords in Inland Revenue Commissioners *vs.* Ayrshire Employers Mutual Insurance Association, Ltd., (1948 I.T.R. Supp. p. 80), it is doubtful whether there can be any "profits" arising out of the business of mutual life insurance associations. Government must make up its mind whether it is going to treat mutual insurance transactions as transactions yielding profits. If it so decides, it must specifically use charging words to make the *surplus* arising from such transactions liable to tax, or declare "income" as including, in the case of mutual insurance companies, the surplus arising from transactions with members. This criticism may not apply to taxation of the investment income of the company as *interest* and not as profits. 126

Recommendation No.		Paragraph No.
	G.—Religious and Charitable Trusts.	
52.	From the observations of Lord Hobhouse in Webb *vs.* England (1898 A.C. 758) it would seem to follow that the exemption from taxation of income accruing from property set apart for the benefit of religious and charitable trusts will be available only in cases in which the purpose of the trust substantially relates to anything done within this country. If this view commends itself to Government, it would be desirable to enact the same clearly by the addition of the necessary words to section 4, sub-section (3), clause (i).	127
53.	There are potentialities for fraud on the trusts and fraud on the Income-tax law by the creation of revocable trusts for charitable and religious purposes. Government should, therefore, decide whether the principle of section 16(1) (c), in so far as it relates to revocable trusts, should be applied even to trusts for religious and charitable purposes. If it is decided so to apply, section 4(3) (i) may have to be qualified by a reference to and by subjecting it to section 16(1) (c). This itself will introduce the same limitation in section 2(15); but to place the matter beyond doubt, the reference to section 16(1) (c) may be repeated in section 2(15) also.	129
54.	Section 4(3) (i) (a) of the Act has been construed as being independent of section 4 (3) (i), and it has been held that business conducted by an educational institution was nonetheless "property" within the meaning of section 4 (3) (i) of the Act, and that the limiting conditions attaching to section 4(3) (ia) did not govern section 4(3) (i). The insertion of clause (ia) in section 4(3) was really intended to operate as a restriction on section 4(3) (i), and it is, therefore, best to remove all ambiguity in the matter by making it clear that section 4(3) (ia) is to be regarded as a proviso to section 4(3) (i).	131
	H.—Collection and Information at Source.	
55.	The existing provisions authorising or compelling deduction of tax at source do not for the time being seem capable of being expanded.	132
56.	The obligation to give verified information on requisition may be imposed on any person who may be assumed or suspected to have made payments of rent, premium, interest, commission, royalty, brokerage, annuity, etc. A statutory obligation may be cast on persons making payments of Rs. 1,000 or more per annum by way of taxable rent, premium, etc., voluntarily to furnish information of such payment to the nearest Income-tax Officer. If the Collating Organisation is made efficient, the lower limit of Rs. 5,000 fixed by Rule 42 for returns to be furnished under section 19-A in respect of dividends paid by companies may be reduced to Rs. 2,000, if not to Rs. 1,000. Where	

Recommendation No. | Paragraph No.

dividends are *collected by Banks (as sometimes* happens) as representing shareholders whose names are not disclosed, either the company may be asked to ascertain or the Banks may be asked to disclose the names of the shareholders on whose behalf the dividends are collected. It may also be useful to enact a provision that persons doing business in India on behalf of non-residents or in respect of goods sent to India for sale by non-residents, should report the fact of such business to the Income-tax authorities, and also give them the names of the non-residents on whose behalf they are doing business or whose goods have been sent to them for sale. 134

I.—Advance Payments and Interest Thereon.

57. We are unable to recommend the repeal of section 18-A of the Act. In this connection the alternative suggestions made by Khan Bahadur Vachha and by the Indian Chamber of Commerce, Calcutta, seem worthy of examination. 135, 136, 137

58. There is reason for differentiating between advance payments under section 18-A and the deductions of tax under section 18 in the matter of allowing interest on the former and not on the latter. The provision which allows interest at 2 per cent. on advance payments but makes the subject chargeable for payment of interest at 6 per cent. in certain contingencies is not without justification. 138

59. If the assessment is not completed before the end of the assessment year, the assessee who has made an advance payment can legitimately claim that he should not be made to suffer for the delay on the part of the Department In this view it seems to us right to allow interest to the asssessee at least at 4 per cent. on the deposited amount from the close of the assessment year, except where the completion of the assessment before that date has been prevented by the conduct of the assessee. 139

J.—Deductions and Allowances.

60. On the question of expenses incurred for business purposes, we recommend that Income-tax Officers may be instructed not to be unduly strict about the amount of expenditure under heads like motor cars maintained and entertainments and amenities provided for the benefit of customers so long as they are satisfied that such amount was actually spent and that no attempt was continuously made to pass off private expenses as business expenses. 140

61. Income-tax Officers should be warned to be on their guard against attempts to show items of capital expenditure on plant, machinery and building as no more than costs of ordinary repairs and maintenance. Whenever they find that any claim under these heads is larger than may seem normal or reasonable for that particular concern, they may be instructed to extmine

Recommendation No.		Paragraph No.
	the items themselves with the aid of experts and place on record for the guidance of future officers the results of their examination.	141
62.	The provision permitting deduction of interest paid on loans borrowed for business does not appear to have led to any large measure of evasion, and we do not recommend any change in sect. on 10(2) (iii).	142

K.—Stock Valua ion.

63.	It has been suggested, firstly, that it may be made compulsory on Auditors to certify the correctness of the stock and not to rely on the certificate of the Manager, and secondly, that the Income-tax authorities should be given power to check stock lists at or about the time of their preparation and to enter premises to satisfy themselves that the stock lists are accurate. The proposal should be given a trial if a provision can be made in the Companies Act accepting the first part of the proposal and in the Income-tax Act for the second, subject to the limitation that the powers of the Income-tax Officer to enter premises shall be exercised only after recording his reasons for taking the step.	146
64.	Where the nature of business is such that the standard rate of profit is uniformly applied on all purchases of each class and such classes can be identified in sales, the method prescribed and followed in the U.S.A. may be used with advantage in Indian conditions to arrive at stock valuation in the case of retail merchants, departmental stores, dry goods stores, etc. The principles is first to increase the cost of the goods purchased by a trader by the standard percentage applied by him to such purchases to cover profits, expenses, etc This brings the cost price on a par with the sale price. If there are no fluctuations in prices, then the realisations on sales have only to be deducted from this value and the balance would represent the selling price of the goods on hand. Reducing this value again by the percentage added previously, will bring it down to the cost. If, however, there have been fluctuations in the prices during the year and these fluctuations have forced a lower price, the selling price has to be marked down at a rate corresponding to the fall. We do not propose, however, that this method should be given statutory authority of a rule, but recommend that it might be included in administrative instructions to Assessing Officers.	147 & 148
65.	In view of the fact that section 13 of the Indian Act is sufficient authority for insisting on proper and consistent valuation of stock, we do not recommend introduction of any rules of the kind enacted in U.S.A. Such provisions might fetter the discretion now enjoyed by the Income-tax authorities to make exceptions in deserving cases.	153

Recommendation No. | Paragraph No.

66. We do not approve of the suggestion that stock should take into account not only price changes but also changes in the volume of the stock, and that any appreciation in the value of the original volume should be excluded from profits. 154

We see no need, at least at this stage, to enforce an elaborate system of rigid rules for stock valuation in this country. The Indian Act is already strong enough to insist on correct valuations being made. It would be sufficient if the Income-tax Officers are instructed administratively to observe principles somewhat on the lines incorporated in the U.S.A. Regulations with variations suited to local practice. This will secure uniformity of practice and help in the gradual training of the trade. 159

L.—USUFRUCTUARY MORTGAGES

67. We recommend the adoption of the advice given by the Ayers' Committee that the income derived by a usufructuary mortgagee of agricultural land be excluded from the definition of "agricultural income" in so far as it represents interest payable to him on the mortgage loan. 160

If it is feared that this proposal amounts to an interference in the provincial sphere, the question may well form the subject of an express agreement between the Centre and the provinces. There is no justification for the mortgagee being allowed to escape liability altogether with neither the Centre nor the provinces taking this portion of the income. 161

M.—Premium on Leases.

68 We think that premia received in connection with leases should be treated as part of the lessor's taxable income. 163

Where the lease is not for a specified term, it may not be wrong to take the whole amount of premium into account in the year of receipt. Where the lease is for a stated period, the fairer method would be to distribute it over the period of the lease though this may not be mathematically the correct method. If the lease is terminated before the expiry of the term fixed, the balance of the premium would become chargeable in the year of termination of the lease, except where it has to be returned to the lessee. The same principles will have to be followed in making a deduction in favour of the lessee in cases in which he may be entitled to a deduction. 164

N.—Unclaimed Balances.

69. We recommend that unclaimed and waived surpluses to the credit of customers, suppliers and employees to the extent they are made up of deductions or allowances previously allowed as admissible

Recommendation No. | Paragraph No.

expenditure when determining assessable income, may be deemed to be profits if they have remained unpaid for over three years. It is not intended to compel the trader or employer to plead limitation. The three years' limit is suggested only as a convenient working rule. It would also be a logical corollary of this rule that if and when the person entitled to these suspense items claims and are paid them, they will once again be allowed as admissible deductions in the year of payment. If an enactment is passed to constitute unpaid wages as a separate fund for the benefit of labour, the above recommendation cannot apply to such unclaimed funds as may fall within the ambit of that legislation. 166

O.—Superannuation Funds

70. If all the requirements of section 58-B are satisfied, it is doubtful if the Central Board of Revenue can refuse to recognise a superannuation fund. The power to impose conditions would probably have reference only to the three eventualities mentioned in the proviso and not in other circumstances independent of these contingencies. 170

The provisions of the Income-tax law in respect of superannuation funds should, as far as possible, be brought into line with those relating to Provident Funds. It is difficult to see why the power given to the Central Government to make rules as in section 58-L(2) should not be repeated in the case of Superannuation Funds. This lack of power to make rules is a serious drawback in the scheme of Superannuation Funds under the Income-tax Act of which unfair use can be made. 171

71. The provisions of the Indian Act with respect to Superannuation Funds need to be amplified and a general power must be given to the Central Board of Revenue to make rules or regulations as has been given to the Commissioners in the United Kingdom under section 32 of the Finance Act of 1921. We further suggest that provision should be made in the Act itself similar to Regulation 8 of Superannuation Funds under the U. K. Act, as amended in 1931, as an exception to the proviso to Explanation 2 of Sub-section (1) of section 7 of the Indian Income-tax Act. 173

72. Suitable amendments may be made in the Indian Act restricting the maximum limit to which the contributions by the employee and employer may be made to 25 per cent. of the employee's salary. 175

73. We do not recommend that the limit of exemptions on interest as laid down in section 58-F shall apply to the aggregate of the interest on the Provident Fund and Superannuation Fund. 176

Recommendation No.		Paragraph No.
74.	Provisions similar to those in section 58-E would be difficult to work in connection with Superannuation Funds and would operate inequitably. If schemes under which employers make premium payments to Insurance Companies to secure an Endowment Insurance Policy of recurring annuities to their employees are to be considered, then the benefits being capable of being traced to individual employees, the contributions might be included in the incomes of the employees on the lines of section 58-E of the Act and that relief should be granted in respect of such contributions under section 15 to the extent the employee would be entitled to if the contributions were life insurance premium payments made by the employee himself.	177
75.	Suitable amendments may be made in section 58-C(i) so as to permit the fund to retain accumulated balances due to any member of the fund, who has ceased to be in employment and at whose request the amount is retained in the fund to be drawn by him at any time on demand. The interest on balances retained in the fund will be liable to tax in the member's hands, but the provision is made only to give certain facilities for protecting the hard-earned savings of a certain class of employees from being frittered away or lost in indiscreet investments.	178
	P.—Super-tax on Associations	
76.	The second proviso to section 55 should be recast so as to permit an assessee's share in the profits of an unregistered firm or other association being included in his total income even though such profits have suffered super-tax. The assessee should, however, get credit on the analogy of section 49-B for the super tax paid by the firm or association in respect of his share of the income of the firm or association.	179
	Q.—Avoidance and Evasion	
77.	An explanation may be added to section 16, sub-section (3), to the effect that for the purpose of that sub-section the word "child" shall include adopted child, foster child, step-child, illegitimate child and grandchild.	181
78.	Sometimes the operation of section 16, sub-section 3, is avoided by each of two brothers making similar settlements in favour of the minor child of the other. It is for Government to consider whether any specific provision should be made in respect of this class of cases.	182
79.	It is desirable to make express provision in respect of shares standing jointly in the name of a person and his wife or his minor child. The appropriate provision will be that where the wife or child became entitled to an interest in the shares without any contribution direct or indirect by or from the estate of the other joint	

Recommendation No. | Paragraph No.

holder (being the husband or ancestor), each of the joint holders must be assessed separately in respect of the dividend in proportion to their beneficial interest in the shares. In other cases, their share of the dividend should also be treated as part of the income of the husband or ancestor, as the case may be. 183

80. If by reason of events subsequent to the transfer, the husband or ancestor should lose his properties, there is no justifiable reason why the income accruing to the wife or minor child should not be independently assessed in the hands of the wife or minor child. It would, therefore, be legitimate to provide that if the tax in respect of the income of the wife or minor child cannot be recovered from the husband or the ancestor, as the case may be, the income may be independently assessed as that of the wife or minor child and the tax so fixed may be recovered from their property, including the transferred property. 184

81 In the case of blank transfers of shares and securities, where a registered holder is not, or has ceased to be, the beneficial owner, the fair course would be to treat the transferor or the registered holder as a bare trustee and the real transferee as the beneficial owner. The dividend or interest on the transferred shares or securities must be assessed as part of the income of the transferee or real owner, except where the transfer itself is ex-dividend. A clause may, therefore, be inserted in the definition section to the effect that "shareholder" is the person beneficially entitled for the time being to the share or to the dividend payable in respect thereof.

82. The principle contained in section 9(3) is, as the law stands, applicable only to assessments of income from property. The principle should be applicable to all kinds of income. It is, therefore, necessary to remove sub-section (3) of section 9 from its present place and enact it as an independent provision applicable to all kinds of income. It may also be necessary to add two more provisions: (i) where shares in companies stand registered in the name of more than one person, they shall be deemed to be held by them as co-owners and the income derived by them by way of dividends on such shares shall, subject to the provisions of section 16, be assessed in the manner indicated in what is now section 9(3); and (2) as that sub-section requires the respective shares to be definite and ascertainable, another clause will be necessary, *viz.*, in the absence of evidence as to the respective beneficial interests of persons in whose names shares may jointly stand, they shall be presumed to be entitled to equal shares therein. To enable the Income-tax authorities to obtain information as to the beneficial ownership of shares, it is necessary to insert in section 38 a provision similar to Rule 11 of the English Finance Act,

1922, which compels a person, in whose name any shares of a company are registered, to state, if so required by a notice in writing, whether or not he is the beneficial owner of those shares and, if he is not the beneficial owner, to furnish the names and addresses of persons on whose behalf the shares stand registered in his name. For non-compliance with the notice, the Income-tax Officer should have power to impose a penalty, if it is considered that a prosecution under section 51 is not desirable.

R.—Bankruptcy and Winding Up

83. The language of Section 230, sub-section (1), of the Indian Companies Act should be amended at least to the extent of allowing preferential payment of one year's assessment if assessed for a period anterior to the winding up, *notwithstanding that the assessment is not made until after the winding up.* Whether the period for which priority could be claimed can reasonably be extended to more than one year, is a matter for consideration. 190

84. It is desirable also to make express provision for tax leviable in respect of profits (if any) earned after the commencement of the winding up or bankruptcy. 191

85. It is desirable to provide either in the Income-tax Act itself just after section 25(2) or by appropriate rules under the Bankruptcy law and under the Indian Companies Act that a Receiver or Liquidator shall, within a specified period after his appointment or taking charge, give notice of that fact to the proper Income-tax authority and, on hearing from him shall set aside, out of the assets available for the payment of the tax, assets to the value of the amount notified. Such provisions are particularly necessary in the case of non-public limited companies. A provision similar to section 215 of the Australian Income-tax Act, 1936, may be introduced in the Indian Act as it provides both for notice to the Income-tax authorities and for the obligation of the trustee to comply with any demand on behalf of the revenue as well as penalty for default. In the case of liquidation of non-public limited companies, it may be worth while to introduce as part of the scheme of section 23-A, provisions corresponding to sub-sections (5) and (6) of section 31 of the U.K. Finance Act of 1927, which enacts that the Liquidator shall be responsible for doing all matters or things required to be done by, or on behalf of, the company, and the Liquidator shall be responsible for the due payment of super-tax payable, by or recoverable from, the company. 192

Recommendation No. | Paragraph No.

S.—Submission of Returns.

86. Instead of having to amend proviso (a) to section 28(1) every time the Finance Act changes the minimum fixed for income-tax liability, it would be desirable to make a self-adjusting provision by enacting that no penalty for failure to furnish a return under section 22(1) shall be imposed on an assessee whose total income does not exceed the maximum amount not chargeable to income-tax by more than Rs. 1,000. 196

87. An Income-tax Officer may require every person to submit a return if his total income in the previous year does not fall short of the maximum amount not chargeable to income-tax by Rs. 500. 197

88. Failure to submit a return under section 22(1) may be made an offence if the income of the person is found to exceed the maximum amount not chargeable to income-tax by more than Rs. 2,000. 198

89. It is desirable to empower the Inspectorate staff to examine the accounts and to take sworn statements from persons whom an Inspector has reasonable grounds to believe to be persons with a taxable income. 199

90. It is not desirable to compel submission of returns by imposing high assessments in their absence. Inadvertent omission to submit a return, even if there be no reasonable cause for failure, should be treated lightly. Reasonable and judicial discretion should be exercised in imposing penalty for failure to submit a return, unless the case can be regarded as an aggravated one by reason of repeated failures or other special circumstances. 200.

T.—Maintenance of Accounts

91. It would not be feasible to impose a legal obligation on all persons to keep accounts. 201

92. Maintenance of accounts should be encouraged by accepting them wherever feasible, unless the defects disclose a desire to conceal profits, or the accounts are so badly kept as to make them useless. The Central board of Revenue should issue directions in this sense. 202

93. Income-tax Officers should have power to—

(1) pay surprise visits to the houses of assessees and their business premises;

(2) search for account books and seize them, if necessary; and

(3) call for succeeding year's account books. 203

94. Primary and subsidiary account books should be preserved for a period of at least 4 years. 204

95. It is not desirable to make audit compulsory, except in the case of businesses with large incomes. 205

Recommendation No.		Paragraph No.
96.	The Central Board of Revenue should consider, in consultation with the Accountancy Board, whether a form of Auditor's certificate, acceptable to the Income-tax Department, can be laid down.	207
97.	In the case of unaudited accounts, statements should be submitted showing how profits have been arrived at from the books of account maintained by the business. The Head Note No. 2 to Part IV of the Return should be amplified to make it incumbent on the assessee to submit a return of his Trading account as well.	209
98.	Income-tax Officers should have power to call upon Auditors to disclose the names of the businesses whose accounts they have audited.	210
	U.—Best Judgment Assessment.	
99.	The practice of making progressive enhancements of assessments should not be applied to every case of a failure to render a return. It should be resorted to where the assessee has adopted a deliberate practice of not making a return of income.	213
100.	An effort should be made to maintain records of market conditions and of statistical data with regard to the rise of prices and such other matters so that when the time of assessment comes, the Income-tax Officer may have some material on which to make as fair an estimate as possible of the profits of the business under assessment.	214
101.	If accounts are not complete, an opportunity may well be given to the assessee to complete the accounts, minor mistakes may well be ignored, more leniency may be shown in cases in which accounts are produced but they are only found to be somewhat unsatisfactory than in cases where no accounts are produced, or the accounts produced are found to be false. Where the Income-tax Officer decides to reject the accounts, he should inform the assessee of his intention to do so and give the assessee an opportunity to adduce any other material that he may wish to adduce to help the Income-tax Officer to form a best judgment assessment.	215
102.	So far as there is any doubt in the interpretation of law, the benefit should go to the assessee; where there is any doubt on a question of fact, having a bearing on the assessment, the principle of section 106 of the Indian Evidence Act may be followed and the benefit of any doubt should go to the revenue.	216
	V.—Penalties.	
103	We are not in favour of the suggestion that persons who do not submit their returns should be disentitled from claiming statutory deductions of certain kinds. An automatic penalty of the kind would operate inequitably. The discretion of the Income-tax authorities to regulate the quantum of penalty should be retained.	218
104.	Section 28 itself should recognise in the penalties prescribed under it the degree of delinquency involved in	

Recommendation No.		Paragraph No.
	the various defaults enumerated in that section. The penalty under clause (a) of section 28 may be 25 per cent. of the tax payable.	219
105.	The penalty under clause (b) may be equal to the tax which would have been avoided if the income returned had been accepted as the correct income.	220
106.	With regard to the penalty under clause (c) of section 28, the element of *mens rea* should not be done away with altogether. The clause should be recast on the lines of section 329 and section 330 of the Codification Committee's draft making a distinction between a person who submits an incorrect return negligently and a person who submits such a return fraudulently. The penalty in the case of the latter may be heavier than in the case of the former.	222
107.	With the enlargement of his revisional powers under section 33-B, added in 1948, the restoration of the Commissioner's powers to impose a penalty is called for; the Commissioner, therefore, may be included among the authorities enumerated in section 28 as competent to impose a penalty.	223
108.	Section 28(1)(c) may be suitably amended so that penalty under that clause may be imposed even if the circumstances attracting the operation of the provision are discovered after the proceedings, in the course of which the misconduct occurred, have been closed. The proceedings taken under section 34 may, for the purposes of section 28(1)(c), be regarded as a continuation of the original proceedings.	224
109.	Imposition of penalty should not be merely mechanical, and judicial discretion should be exercised in the matter.	226
110.	The statutory previous sanction of the Inspecting Assistant Commissioner should secure that the power to impose penalty is not lightly exercised, especially if it is the first default of the assessee. As the law prescribes only the maximum penalty, each case should be treated on its own merits.	227
111.	Both in the interest of the assessee and the Department, it is worth while to encourage the honest defaulter to come forward, even if it be after the expiry of the notice date, and file a return *suo moto*. A proviso should be added to section 28(1), before or after the existing proviso (a) to section 28(1), to the effect that no penalty for failure to furnish a return in response to a notice under section 22(1) shall be levied if, before the issue of a notice to him under section 22(2), a person delivers a return as required under section 22(1), and the Income-tax Officer is satisfied that the omission to furnish the same within the prescribed period was due to ignorance, mistake or other sufficient cause.	228
112.	Before giving his approval to the imposition of a penalty, the Inspecting Assistant Commissioner should give an opportunity to the assessee of being heard and	

Recommendation No.		Paragraph No.
	if, after hearing him, he gives his consent to the order of penalty proposed to be passed, the appeal against such order should lie direct to the Appellate Tribunal. If the proposal to make the Appellate Assistant Commissioners independent of the Department is accepted, then there is no harm in the appeal being heard by the Appellate Assistant Commissioner as at present.	229
113.	The penalty under section 28(1), clauses (b) and (c), should, as far as possible, be related to attempted concealment. The principles laid down in the Central Board of Revenue Circular No. 40 of 1941 are generally sound, but the Income-tax Officers must carefully consider whether a case is merely one of concealment of a particular item or items, or the concealment which they may discover is such as to suggest that the accounts are unreliable and should be rejected. Though the discovery of concealment may be a common factor to both cases, the two cases obviously belong to different categories for the purpose of penalising the assessee. The Circular may, therefore, be suitably modified so as to bring these considerations clearly to the notice of the Income-tax Officers.	230
114.	Normally, the procedure by way of levying a penalty under section 28 should be followed in preference to prosecution. Prosecution should be resorted to in flagrant cases or in cases of repeated violation of law, or where the imposition of penalty has had no effect, or where the amount involved is large. In order that the prosecution may have a deterrent effect, section 52 should differentiate between the less serious and more serious offences and, in the case of the latter, imprisonment should be made either simple or rigorous, and the limit of fine may be extended to Rs. 10,000. Unless the case is a gross one, compounding may be resorted to, but the policy should, as far as possible, be uniform, so that no occasion should arise for the criticism that a rich man can, if found out, purchase his freedom by payment of money while the poor man has to go to jail. The sanction of the Central Board of Revenue should invariably be obtained both for prosecution and for composition so as to maintain uniformity of treatment. Those on whom a penalty has been levied more than once under section 28(1)(c), or who have been convicted in respect of more serious offences under section 52, should be held to be disqualified for membership of legislative or local bodies, or for acting as trustees, unless Government in special cases agrees to set aside the disqualification. The operation of section 54 of the Act may to this extent be excluded where with the sanction of the Commissioner the fact of an assessee having been subjected to a penalty under section 28(1)(c) has to be made public.	235 and 236
115.	The Central Board of Revenue or the Commissioners should draw up a list of persons who are entitled at present to appear as Income-tax Practitioners by reason	

of possessing qualifications under section 61(2)(iv)(a) of the Act and of those at present qualified under section 61(2)(iv)(b) and (c), provided that the latter pass an examination in Income-tax Law and Accounts similar to that prescribed for Income-tax Officers. No further addition need be made to the list unless the person who proposes to practice as an Income-tax Practitioner passes such an examination. All Income-tax Practitioners having their names on the roll maintained by the Commissioners or the Central Board of Revenue should be required to conform to a code of professional conduct and discipline prescribed by the Central Board of Revenue. 240

116. We should adopt the English practice and add a sub-section to section 28 so as to provide that a person who wilfully and knowingly abets any person who has rendered himself liable to a penalty under circumstances mentioned in section 28(1)(c) of the Act, may be ordered by an Income-tax authority to pay a fine which may extend to Rs. 500. An appeal may be provided against the imposition of fine on the abettor. The appeal should be heard along with the appeal, if any, against the assessment in the proceedings which resulted in the imposition of the fine on the abettor. 241

W.—Secrecy and Publicity

117. The principle of secrecy and confidence attaching to the Income-tax proceedings is not to be lightly violated, but it is equally important that these principles should not afford a cloak to the assessee to make reckless statements in order to avoid tax liability with the assurance that such statements will not involve him in any serious consequences. The provisions of section 54 may be relaxed in the following cases:—

Disclosures of confidential information to—

(1) the Advocate-General where it appears that there had been a breach of trust relating to charity, so that the Advocate-General may, if so advised, take suitable steps in the matter;

(2) the Provincial Government in respect of information having a bearing on the recovery of Sales Tax. [This provision is indistinguishable in principle from the provision at present contained in clause (j) of sub-section (3) of section 54.]; 244

(3) the proper authorities when the assessee makes, in the course of Income-tax proceedings, statements which implicate him in criminal offences, when such statements have been made with a view to escape liability under the Income-tax Act; and 245

(4) a third person where the assessee asserts the right of such third person to certain property or income, and the Income-tax authorities have reason to believe that such assertion is not true and has been made with a view to escape or reduce liability to income-

Recommendation No.		Parapragh No.
	tax. [This provision is analogous to section 7(4) of the Income-tax Investigation Commission Act, and should be adopted as a part of the ordinary law relating to income-tax.]	246
118.	The proposal of giving wide publicity to persons who are found to have made gross understatements of their income may be dropped.	247
119.	There is advantage in public exposure of persons who are guilty of deliberately cheating the revenue.	248

X.—Cancellation of Assessments, Revision and Review.

120.	Freer use may be made, especially in cases decided under the proviso to section 13 or under section 23(4), of the power under section 27 to cancel assessments, particularly where the Income-tax Officer is satisfied that the true accounts of the assessee are forthcoming at that stage.	251
121.	Where it has been established to the satisfaction of the Department that earlier assessments were made owing to a *bona fide* mistake on the part of the Department or the assessee, it should be within the power of the Commissioner to relax for just and adequate cause the time limit of one year imposed under section 33-A of the Act.	252
122.	Where justice cannot be done by the exercise of the revisional powers under section 33-A, or by way of rectification under section 35, a limited power of review may be conferred on the Income-tax authorities similar to that possessed by the Civil Courts on discovery of new material which could not have been produced with due diligence during the original proceedings.	253

Y.—Appeals

123.	There should be a right of appeal (1) against an order under section 35 (rectification) and (2) against an order of an Appellate Assistant Commissioner refusing to extend the time for filing an appeal or dismissing an appeal as not filed within time. The appeal against an order under section 35 should lie both in cases where the authority takes action and makes an order of rectification, or refuses to take action. The appeal against an order under section 35 should be limited only to the rectification ordered or to the refusal to make an order of rectification. It should not be open to the appellant on such an appeal to reopen the merits of the original order, except to the extent permitted by section 35.	254
124.	There should be a right of appeal against an order appointing a person as an agent of a non-resident.	255

Recommendation No.		Parapragh No.
125.	Where an order has been passed under section 23-A of the Act, directing that the undistributed portion of the previous year's assessable income of a non-public company should be deemed to have been distributed as dividend among the shareholders, any share-holder should have a right of appeal against such an order, even though the company has not chosen to appeal.	256
126.	Where an order has been passed under section 23-A(3)(ii) that the proportionate share of a member of a non-public company in the undistributed profits be included in his total income and the tax payable in respect thereof is made recoverable from the company, the company should have a right of appeal against such an order.	257
127.	Where a non-resident person has failed to pay the tax after assessment and still desires to prosecute his appeal against it, he should either deposit one-half of the amount of the tax payable, or give security for the full amount before such appeal comes on for hearing. A request in this behalf should be made before the Appellate authority by the Income-tax Officer after he has obtained the previous approval of the Inspecting Assistant Commissioner. Where the order under appeal is *prima facie* so unsustainable that it would be an unjustifiable hardship upon the non-resident to ask him to furnish the deposit or give the security, the Appellate authority may waive such requirement.	259

Z.—Stay of Recovery Proceedings

128.	Specific provision should be made in the Act enabling the Appellate Assistant Commissioner, the Appellate Tribunal, the Commissioner or the High Court to stay the recovery of the tax, penalty or interest pending the disposal of the appeal, application or reference, as the case may be, to the extent to which such tax, penalty or interest is in issue before them. Such order may be passed if, on perusal of the order which is the subject matter of an appeal, application or reference, they have reason to think that the order is contrary to law or otherwise erroneous and unjust. Applications for stay should be required to be filed without unreasonable delay, and on such application notice should be issued to the Income-tax Officer concerned. On hearing the Income-tax Officer, the Appellate Assistant Commissioner, the Appellate Tribunal, the Commissioner or the High Court, as the case may be, may call upon the assessee to give security for so much of the amount as is covered by the stay order. If ultimately the assessee fails either wholly or partially, he should be required to pay interest at 8 per cent. on the amount originally stayed, but subsequently ordered to be recovered pursuant to the decision in the appeal, application or reference.	261

Recommendation No. | Parapragh No.

AA.—Appellate Procedure

129. It would be unfair to forbid the production of evidence at the appeal stage, where the assessee had no opportunity to produce the necessary evidence or was not sufficiently informed of the points on which evidence was required to be adduced. But the Appellate Assistant Commissioner should not allow fresh evidence to be brought on record in cases where the relevant material was wilfully withheld by the assessee before the Income-tax Officer. In order to enable the Appellate Assistant Commissioner, or the Appellate Tribunal, to decide whether the evidence was wilfully withheld, the Order sheet should show what opportunity was given to the assessee to adduce evidence and on what points evidence was required to be produced. Notice under section 22(4) should indicate with some degree of precision what documents and accounts were required to be produced. All this may be provided for by a statutory rule. 265

130. It should be for the appellant to prove, in the first instance, that the order made by the lower authority is incorrect. But if the order is, in the very nature of the case, based upon findings which it would not be possible for an appellant to controvert out of his own knowledge, then it should be for the Income-tax Officer or the Departmental Representative to satisfy the Appellate authority that the order appealed against is reasonable. The Appellate authority itself must be satisfied that the order of the Income-tax Officer or the Appellate Assistant Commissioner is not unreasonable, and even where the appellant fails to adduce sufficient reason against the order, the Appellate authority cannot divest itself of its responsibility to see that the assessment is not unfair. Where the Appellate authority feels that the Income-tax Officer's decision is unreasonable, or, as the Courts say, no reasonable man could have arrived at that decision, the burden would shift to the Income-tax Officer to satisfy the Appellate authority that his estimate is reasonable. Convention might be developed that the order of the Income-tax Officer or the Appellate Assistant Commissioner should not normally be superseded, unless the Appellate authority felt that the order of the Income-tax Officer or the Appellate Assistant Commissioner was unreasonable and there was sufficient ground to come to a different conclusion and not merely because it would itself have come to a different decision if it were the first authority deciding the case. 268

131. With regard to appeals against best judgment assessments, the Commission is unable to agree with the suggestion that assessments under section 23(4) should be made non-appealable. 269

132. The scope of an appeal against a best judgment assessment must include the consideration of the question whether the Income-tax Officer was right in proceeding under section 23(4), or under the proviso to section 13. If the assessee had an opportunity and was in a position to produce relevant evidence but had wilfully withheld

Recommendation No. | Paragraph No.

it from the Income-tax Officer, he should not be allowed to lead such evidence for the first time before the Appellate authority. If even with these precautions fresh material is admitted, the Appellate authority should give due weight to it and the estimate made by the Income-tax Officer may be set aside only if it is found to depart materially from the estimate made by the Appellate authority after such consideration. 270

133. Appellate orders which accept most of the arguments advanced by the Income-tax Officer but merely make a slight variation in the percentage of profits estimated by the Income-tax Officer, are calculated to add to the difficulties of the Assessing Officer while encouraging the assessee to gamble on the chance of a reduction by the Appellate authority. Save in special circumstances, the Appellate authority should not interfere with the estimates made by the subordinate authority if they are not wide of the mark. 271

BB.—Refunds

134. It should be possible to expedite the work of refund with some planning and proper supervision. Where the staff is inadequate, it should be brought to the proper strength required for quick disposal. The Central Board of Revenue might consider if some system on the lines indicated in paragraph 125 of the Report of the Departmental Committee on Income-tax in the United Kingdom might not be adopted with profit. 278

135. It should be impressed on Income-tax Officers that the disposal of refund applications is as important a part of their duty as that of making assessments and that any dereliction of this duty would be taken serious notice of. In order to compensate in some measure the applicants for refund, for the delay in making refunds, they should be entitled, after the expiry of 6 months from the date of the receipt of the application, to interest at 2 per cent. on the sum found due to them, unless the applicant himself is mainly responsible for the delay in the disposal of the application. 279

136. In respect of refunds arising as a result of orders of Appellate authorities under section 48(2), or of orders in revision made by Commissioners under section 33-A, or of orders in rectification made under section 35, the liability to pay interest should arise 3 months after the expiry of the order which necessitates a refund. 280

137. The legal difficulty which prevented the Privy Council in the Tribune Trust case from ordering refund of the tax, which subsequent decision of the Privy Council proved that the Department had no right to recover should be removed and it should be enacted that, where parties are the same and the point in dispute is the same, the later assessments must be treated to have been conditional though they are not formally made the subject of pending proceedings each year. Similarly, in order to

Recommendation No. | Paragraph No.

protect the interest of revenue, a provision should be made that when the dispute is the same, relates to the same assessee and the final judgment in an earlier assessment proceeding indicated that the subsequent assessments should have been made on a different basis, it should be open to the Department to revise the subsequent assessments in the light of the final judgment, and the time limit imposed by section 33-B and section 34 should not be a bar in such cases. 281

138. Section 50 may be suitably amended so as to provide that an application for double income-tax relief in cases falling under sections 49, 49-A and 49-D may be made within one year from the date of assessment either in India or in a foreign country, whichever is later, in spite of the fact that the period prescribed for making such claims under section 50 may have expired. 282

139. The provision which enables the High Court to make an order authorising the Commissioner to postpone payment of a refund consequent upon the decision of the High Court on a reference, pending the disposal of the appeal to the Privy Council, should appear not as a proviso to sub-section (7) of section 66, but as an independent sub-section. 283

140. The refund due, as a result of an order in appeal, may be withheld until the period for filing an appeal or making a reference to the High Court against that order has expired. The question of withholding a refund, or allowing it to be paid after an appeal has been filed or a reference obtained, should be left to the discretion of the superior authority, *viz.*, the Appellate Tribunal, or the High Court, as the case may be. If an appeal is filed or a reference to the High Court obtained, the Income-tax Officer or the Commissioner, as the case may be, should file a separate application, stating reasons why it would be inexpedient in the interest of the revenue to allow refund being made under the order complained of. The Appellate Tribunal or the High Court, as the case may be, on sufficient cause being shown, should either order stay of the refund or permit the refund to be made on the assessee furnishing security to the satisfaction of the authority making such order for the restitution of the amount so refunded. No such order should be made unless the authority, after notice to the assessee, is satisfied (1) that substantial loss may result to Government unless an order were made; and (2) that the application has been made without unreasonable delay. It should be competent for the authority to make such an order *ex parte*, pending the hearing of the application If the whole or any part of the refund amount withheld has to be ultimately paid to the assessee, the assessee should be entitled to interest thereon at 3 per cent. per annum from the date when such refund became due to the date of the actual payment. 285

Recommendation No. | Paragraph No.

CC.—Powers of Income-tax Officers

141. Income-tax Officers should have powers to gather relevant information, particularly (1) to deal effectively with persons suspected of having black-market dealings; (2) to enter business premises and inspect accounts maintained therein, place identification marks thereon, and make copies therefrom, and if the officer has reason to think that they may not be forthcoming when required, to impound them; (3) to make a search of places where there are reasonable grounds for believing that relevant books and records have been kept; and (4) to call for relevant information from Banks and other business houses. 290

Whenever possible, action under clauses (2) and (3) above should be taken with the previous concurrence of the Inspecting Assistant Commissioner. Where such a course is not possible and such powers have been exercised, a report should be made to the Inspecting Assistant Commissioner stating the reasons that called for the exercise of those powers and the result actually obtained by their use. It should be the business of the Inspecting Assistant Commissioner to see that the powers are sparingly used and after circumspection. If the powers are misused, the Inspecting Assistant Commissioner should guide the Income-tax Officer in the proper exercise of those powers and, if necessary, warn him. 293

142. It would be an advantage to have a specific provision enabling Income-tax Officers to call for total wealth statements, wherever they consider it necessary to do so. 299

Calling for such statements should not be regarded as a routine process to be gone through every year or in the case of every assessee. The power should be exercised occasionally and with discrimination. Whenever an Income-tax Officer considers it necessary to call for such statement, he should record in writing his reasons for so doing. An *ex post facto* check by the Inspecting Assistant Commissioner would be sufficient and will place an Income-tax Officer on his guard against indiscriminate exercise of the power. 302

If such statements on oath are to be called for, it would be necessary to make a specific provision in section 52 of the Act for the prosecution of the assessee who makes a statement which is false, and which he knows or believes to be false, or does not believe to be true. 303

143. Although other systems of legislation give statutory sanction to payment of rewards for information having a direct bearing on the tax, the system is likely to be abused and a general invitation to informers with the inducement of a reward may actually result in more harm than good. The Commission, therefore, makes no recommendation in that behalf. 306

Recommendation No. | Paragraph No.

144. Where, before the completion of assessment proceedings, an Income-tax Officer is succeeded by another, the proceedings may be continued by the second Income-tax Officer from the stage which they have already reached, but in case the assessee so wishes, or the second Income-tax Officer himself so desires, in order to do full justice to the case, the proceedings should be started *de novo* in the matter of actual recording of the evidence. The preliminary steps, like the issue of notices, etc., need not be gone through over again. Income-tax Officers should be directed, as far as possible, to complete the cases on their hands before relinquishing charge, especially cases where the inquiry has proceeded to an appreciable extent. 309

DD.—Inspecting Assistant Commissioners

145. The Commission is not in favour of the suggestion that a non-official agency should be set up for the making of the assessments and that before such agency Income-tax Officers should represent the Department. It would also not be practicable that the officer making the assessment should be a person different from the officer who makes investigation into the case. In a large majority of cases, therefore, assessments may continue to be made by the Income-tax Officer as at present, but there should be no interference whatsoever by the Inspecting Assistant Commissioner in respect of pending assessments. If a case is of any special difficulty, it would be desirable that the whole assessment should be done by the Inspecting Assistant Commissioner himself by taking advantage of the provisions of sub-section (5) of section 5. Such cases should be investigated by the Income-tax Officer but the assessment should be made by the Inspecting Assistant Commissionoer. It should be provided that, from the order of the Inspecting Assistant Commissioner in such cases, appeal shall lie direct to the Appellate Tribunal. 314

146. If an Income-tax Officer considers that in a particular case he would like to have the advice of his Inspecting Assistant Commissioner, he should have the opportunity to consult him; but in such cases and in all cases where an Inspecting Assistant Commissioner exercises powers specifically vested in him by the Statute, the Inspecting Assistant Commissioner should give an opportunity to the assessee to place his point of view before him and, after hearing him if he appears, the Inspecting Assistant Commissioner may give such advice to the Income-tax Officer, or pass such order, as he thinks fit. The Commission strongly disapprove of the practice of the draft orders of the Income-tax Officers being, in the first instance, submitted to the Inspecting Assistant Commissioner for approval, and then issued by the Income-tax Officer as his own orders. 315

Recommendation No.		Paragraph No
147.	The remarks made above with regard to the advisability of the Inspecting Assistant Commissioners giving directions to Income-tax Officers in pending cases, apply equally to the Directorate of Inspection.	316
	EE.—Appellate Assistant Commissioners	
148.	The experiment begun in 1938, should be carried forward, and Appellate Assistant Commissioners should be removed from the control of the Commissioners and the Central Board of Revenue, and should be placed under the Appellate Tribunal. Their leave, transfers and postings should be in the hands of the Tribunal.	319
149.	With regard to the suggestion that Appellate Assistant Commissioners should be recruited from among the senior Subordinate Judges, the Commission feels that although it is desirous of encouraging the judicial outlook in Appellate Assistant Commissioners, the nature of their work requires an intimate knowledge of Income-tax work which one cannot ordinarily expect a purely judicial officer to acquire even after a brief period of special training. The experiment may be tried in a few instances if Government see no other difficulty in the way of doing so.	320
150.	The normal avenue of promotion for Appellate Assistant Commissioners should be to the Appellate Tribunal. It is doubtful whether on the pay at present offered to a member of the Appellate Tribunal, especially as the appointment is for short terms, successful members of the legal and accountancy professions would come forward to accept these posts, and it would be inadvisable to recruit second rate men from the professions to man such posts. If men with the requisite qualifications and experience from the legal and accountancy professions are not forthcoming in sufficient numbers, it would be advisable to recruit members from the Judicial and Income tax Departments. It is not suggested that members of the legal and accountancy professions should not be appointed to the Tribunal, but once they are appointed they should be expected to hold the posts on a permanent basis and should not expect to revert to the profession after the expiry of their period of appointment. The appointments to the Appellate Tribunal should be made by the Ministry of Law on the advice of the President of the Appellate Tribunal. If by reason of the fact that there are not likely to be sufficient places on the Appellate Tribunal to afford reasonable prospects of promotion to Appellate Assistant Commissioners, the Commission recommends the creation of a few posts in the grade of Appellate Assistant Commissioner carrying a salary approximating to that of Commissioners of Income-tax, so that some senior Appellate Assistant Commissioners may be appointed to them.	321

Recommendation No.		Paragraph No.
151.	The Commission does not consider it necessary to press at present the proposal that there should be only one appeal on questions of fact, namely to the Assistant Commissioner in certain classes of cases and direct from the Income-tax. Officer to the Appellate Tribunal in other cases.	322

FF.—Appellate Tribunal

152.	Some adequate machinery should be devised, after consultation with the Tribunal, for the reporting of the decisions of the various Benches, and also for the conflict in the decisions being resolved by a full Bench of the Tribunal.	323
153.	Wherever a conflict exists between the decisions of two High Courts, it should be within the power of the Tribunal to refer the point of law for the opinion of the Supreme Court, whose decision will be binding on all the High Courts.	324
154.	The Tribunal should have power to order costs to be paid in any appeal pending before it. It should also have discretion to order that the whole or part of the fees paid by the appellant assessee under sub-section *(3) of section 33 be refunded to the appellant, depending* upon the degree of success which such appellant has obtained in his appeal.	325
155.	An assessee, who makes an application for reference to the High Court, has to make a deposit under section 66(1). Whether such deposit be regarded as a check against frivolous applications or analogous to the Court Fee on a Memorandum of Appeal, the successful applicant is entitled to a refund of the deposit. Sub-section (6) of section 66 may, therefore, include a specific provision for a direction for the refund of the deposit, or part therof, in appropriate cases.	326
156.	The Commission does not consider it necessary to give the Appellate Tribunal power to vary, in favour of the Department, the order under appeal in respect of any item disallowed by the Appellate Assistant Commissioner even if the Department has not chosen to file an appeal against the Appellate Assistant Commissioner's order. It is, however, conceivable that Government may not choose to appeal against some portion of the Appellate Assistant Commissioner's order so long as the assessee was prepared to acquiesce in the order as a whole. Such cases may be met by enabling Government to file a memorandum of objections against so much of the order of the Appellate Assistant Commissioner as is against Government, provided it is filed within 30-days of the service upon them of the notice, referred to in rule 20 of the Appellate Tribunal Rules, of the appeal having been filed by the assessee.	327

Recommendation No.		Paragraph No.
157.	Sub-section (1) of section 66 fixes a period of 90 days from the date of an application for reference, for referring any question of law, to the High Court when the Tribunal decides to make such a reference. This provision now prescribing 90 days' limit may be deleted, and the Tribunal may be trusted to make the reference as soon as practicable.	328
158.	The concession given by section 5 of the Limitation Act should apply not merely to applications made by an assessee under sub-sections (2) and (3) of section 66, but also to an application made by the Commissioner under sub-section (1). Sub-section 7(A) of section 66 should, therefore, be modified in this sense. *Section 5 of the Limitation Act is made applicable* only to applications made to the High Court. There is no provision for extending for just and sufficient cause the period prescribed in sub-section (1) for making an application to the Tribunal, praying for a reference to the High Court. Just as the Tribunal can, under sub-*section (2) (a) of section 33, admit an appeal after the* expiry of the period of limit, where it is satisfied that *there was sufficient cause for its not being presented* within that period, it should have a similar power in admitting applications for a reference to the High Court after the period of 60 days, mentioned in sub-section (1) of section 66, has expired. Sub-section (7) (A) of section 66 should be amended in this sense also.	329

GG.—Miscellaneous Recommendations

159.	**Section 2 (11).**—It is necessary to link up the option given to an assessee to say when his "previous year" ends under clause (c) with a similar option under clause (a) so that the profits of some period of the business may not escape assessment. The option under clause (c) should be exercisable within 12 months of the setting up of the business.	331
160.	**Section 4 (1) (b).**—As it has been held that the remittances made during the accounting year cannot be assessed as "profits" of that year, because no "profits" can arise until the accounts are made up at the end of the year, a provision may be added as another explanation after the Explanation (1) to section 4 (1) that where remittances are made to or received in the Indian Union by a person earning income outside the Union, and it is ascertained that the accounts were made up in respect of the year during which the remittance was made, that such person earns a profit in the business carried on by him outside the Union, such remittances made to the extent to which they could have been sent out of the ascertained profits be presumed to have been remitted out of such profits.	

Recommendation No.		Paragraph No.
161.	In Explanation 2 to section 4 (1), the words "and not being pension payable without India" may be omitted, as there is no longer any need or justification for that exemption.	**332**
162.	**Section 4-A (b).**—It would be safer to insert the expression "in any year" in sub-section (v) of section 4-A, and the sub-section may be recast as follows:— "A Hindu undivided family, firm, or other association of persons is resident in British India in any year in which the control and management of its affairs is not situate wholly without British India."	333
163.	On the language of section 4A(b) an assessee may in conceivable cases have to be dealt with as a resident and non-resident in respect of his different sources of income. This is anomalous. A provision should, therefore, be added that a person shall be deemed to be resident in British India for all purposes of the Act if he, or it, is resident in British India in the previous year in respect of any source of income, notwithstanding that he, or it, is not resident in British India in the previous year or years in respect of any other source or sources of income.	334
164.	**Section 9.**—The Commission is not in favour of the suggestion that depreciation should be allowed on house property which is habitually let out on rent and the rent from which is assessed under section 9 of the Indian Income-tax Act.	339
165.	**Section 10 (2) (vii).**—This clause should be amended by the inclusion of the words "or furniture" so as to permit allowance being claimed for furniture which has been sold or discarded.	340
166.	**Section 10 (2) (x).**—The language of clause (x) may be so modified as to enable the Department to allow the whole or part of the bonus or commission as a legitimate deduction in either or both of the cases, *viz.*, (1) where it may be regarded as legitimate in respect of some employees and unjustifiable in the case of other employees; or (2) the amount paid in some cases be regarded as excessive and the Department is prepared to recognise only a part of it as legitimate payment by way of bonus or commission. It would also be desirable to give a clear indication as to whether cases of employees being regularly remunerated on a commission basis are expected to be dealt with under sub-clause (x) or sub-clause (xv).	342
167.	**Section 24.**—The result intended to be achieved by the insertion of the words "otherwise than by inheritance" in proviso (e) to sub-section (2) of section 24, *viz.*, when an individual dies, the carrying forward of losses should not die with him but ought to be	

carried over in the hands of the son and that he must be entitled to set off the losses against the profits that may accrue, can more appropriately be brought about by the insertion of the words "or his heir-at-law" in sub-section (2) itself. 343

168. **Sections 25 (3) and 25 (4).**—To delete the provision in section 25 (3) altogether would be a breach of faith on the part of Government and might do injury to many genuine investors. But the tax concessions under sections 25 (3) and 25 (4) have now practically outlived their purpose with the march of time and they might be withdrawn after providing for such a tax concession as might absolve Government from a charge of breach of faith. This might be done as follows. In arriving at the amount of tax to be demanded, the assessee should be given credit for the tax on assessable income of the relevant period at the rate that would have been applicable to that income under the Finance Act of 1938-39. 349 & 350

169. **Section 25A.**—Where proceedings under section 34 have to be taken long after the disruption of a joint Hindu family, it would be desirable to make an express provision specifying the persons to whom notices should be given and the steps that may be taken to recover the tax that may be assessed. 351

Similarly, in such a case express provision will have to be made as to the officer entitled to initiate proceedings under section 34 of the Act. 352

170. **Sections 31 and 33.**—Where a matter has been disposed of in the absence of the assessee, there is no provision made for its being restored or reopened even if the assessee is able to show justifiable cause for his non-appearance. In this respect the position must at least be brought on a par with section 27. 353

171. **Section 36.**—The suggestion that it may be sufficient to make calculation to the nearest rupee may be favourably considered if it is likely to save trouble to the office in working out calculations. 354

172. **Section 45.**—It should be provided either in section 29 or in section 45 that the time allowed for payment of tax should be not less than a month. 355

173. **Section 50.**—As a matter of principle, the power to excuse delay in applying for refund should be available in all cases provided sufficient cause is shown for not making the claim within the period prescribed. 356

HH.—Administration

Recruitment

174. Recruitment to the cadre of Income-tax Officers should be made partly directly through the Federal Public Service Commission and partly by promotion

Recommendation No. | Paragraph No.

from the subordinate ranks. Recruitment through the F.P.S.C. is to be preferred to other methods of direct recruitment, namely, selection from Registered Accountants, employees in business houses, practising lawyers, etc. The curriculum for the F.P.S.C. Examination may, if necessary, be enlarged so as to include Accountancy and Law among the subjects that can be offered for examination, if this is not already the case. To encourage candidates, who have knowledge of law or of accountancy, to take this examination, a higher age limit may be allowed to such candidates to enable them to acquire greater practice or experience in those subjects. 369-370

The proportion of promotions from the subordinate ranks to direct recruitment to the Income-tax Officers' cadre should be 1/3rd. to 2/3rd. and, once a person is promoted to Class I Service by this method, no distinction should be made on account of the method of his recruitment in his future prospects and promotion. 372

In order to make the Service attractive, better chances of promotion should be provided by making the junior grade of Income-tax Officers smaller than the senior one and by using the provisions of section 5(5) more liberally, to increase the number of posts carrying the pay of Assistant Commissioners available to Income-tax Officers. 372

Government should assure by word as well as by deed that members of the Income-tax Service will be eligible for the highest posts in that Service and that, if reservations are made for posts in the Service for members from the 'Pool' cadre, they will be compensated for such reservations by a corresponding number of posts in the 'Pool' cadre for the Income-tax Service. 374

Government should treat with sympathy the grievances of the Department as they are brought to their notice. Confirmations should be expedited. If Class II Officers are used for Class I work, then they should be either promoted temporarily to Class I or remunerated by additional payment for doing more important work. 374, 376 & 379

The present method of appointing 'Pool' Officers to posts in the Income-tax Department should be continued, but no one should be appointed or promoted to the Commissioner's post until he has had at least 3 to 5 years of active service as Inspecting Assistant Commissioner and, secondly, such 'Pool' Officers must be encouraged to continue in the Department by providing sufficient prospects of promotion to them in the Department itself.

Recommendation No. | Paragraph No.

Training of Officers

175. The training to be given to Officers directly recruited to the Department should be improved in the direction of giving them greater experience of outdoor work such as Survey and Inquiries and more varied acquaintance with accounts, particularly of important trades and industries. The period of training should, therefore, be extended and the training should be completed under the supervision of Principal Officers in preference to Inspecting Assistant Commissioners.

The training scheme should also include training of non-gazetted sub-ordinates. 384, 385 387 & 388

Organisation and Distribution of work

176. A change in the duties of the Directorate of Inspection is recommended. Instead of stress being laid as at present on a routine scrutiny of inspection reports submitted by Inspecting Assistant Commissioners, the Directorate should only collate the major defects disclosed in provincial Inspection Reports and issue instructions of an all-India character to avoid repetition of those defects. The Directorate might also undertake 'sample checks' at random with the help of Accountants as is done in the U.S.A. 393

The Directorate might concentrate more on developing and maintaining an Investigation Branch in addition to its present duties. It might also be in charge of special assessment circles. 394

The designation of the Director might be changed to that of "Chief Commissioner of Income-tax" with a status corresponding to that of the Deputy Chief Inspector of Taxes under the U. K. system. 395

177. The Commissioner of Income-tax should be allowed to exercise more powers than he is able to do under the present scheme of centralisation. He should be responsible to judge and take action on inspection reports by Assistant Commissioners and should be left free to decide on points thrown up by day to day administration, namely, penalties, individual assessments, etc. 396

178. Inspecting Assistant Commissioners should be given powers to call for and examine account books themselves wherever necessary, to make their inspections more effective and instructive. They should place before themselves the example of senior Inspectors in the U. K. whose relations with their juniors are those of an elder brother towards a younger one. 397

179. The allocation of work to Income-tax Officers by categories and the fixation of standard output in terms of standard units is not disapproved; but, distribution into categories should be not by the amount of income but on the amount of work involved which only local knowledge can supply. In considering the

Recommendation No.		Paragraph No.
	involved for fixing the standard unit, not only the time taken in examination of accounts should be considered but also the time required by the Income-tax Officer and his inspecting staff for study and for application of tests to the evidence produced before him.	400 & 401
180.	Jurisdictions of Income-tax Officers should be re-arranged so as to provide for multiple Income-tax Officers' jurisdictions in preference to single Income-tax Officer's jurisdiction. Special jurisdictions should be created for special classes of business and Specialist Officers should be trained to undertake them. Specialist Circles for assessing Textile Mills, Insurance Companies, Banking Companies, Iron and Steel Companies, Share and Stock Brokers and such other classes of business, are recommended.	402 & 403
	Arrears:	
181.	The following suggestions are made to reduce the number of arrears and to prevent accumulations in future:	
	(i) The system of Examiners may be reintroduced for giving assistance to Income-tax Officers in complicated cases, but these Examiners should be Gazetted Officers to be called Assistant Income-tax Officers.	412
	(ii) The annual work to be done by the Income-tax Officer should be reduced (a) by staggering methods and (b) by improving the Return Forms, so as to call for more information than is furnished at present.	414
	Inspectors and Survey:	
182.	More importance should be given to Survey than is given at present and the staff of Inspectors may be increased for the purpose, if necessary. The Survey Staff should include junior Gazetted Officers, Assistant Income-tax Officers or Probationary Officers to do preliminary work in connection with assessments in 'Trial Cases'.	417 & 421
	Inquiries should be made contemporaneously, from newspapers, business deals and Court proceedings without waiting till the commencement of the assessment for which such information may have to be used.	422
	Investigation Branch:	
183.	The Investigation Branch should be expanded and strengthened. It should work at three levels, namely, (a) in the Income-tax Office where information may be collected from assessment files and from inquiries, (b) in the Commissioner's office where a Special Bureau should be opened for this purpose and (c) in the office of the Central Board of Revenue. The Commissioner's establishment should collect information from different sources, *e.g.*, from Departments of Govern-	

Recommendation No. | Paragraph No.

ment and Local Bodies, etc. The establishment with the Central Board of Revenue should collect similar information from Government of India offices and collate this as well as information of an all-India character forwarded by the Commissioners. 423 to 425

With the expansion of the machinery for investigation, that for collation must also expand. The Collation Branch should be further strengthened by machinery to keep track of its intimations 425

184 To enable Inspectors and Assistant Income-tax Officers to discharge their duties of investigation and inquiry, they should be given a recognition under the Income-tax Act and the statutory authority to take statements, etc. 426

185. Appropriate and adequate machinery for collection of taxes should be maintained. 428

186. The conditions of work of the ministerial staff should be improved and proper training should be given to them. 429

Equipment:

187. The equipment and furnishings in the Income-tax Officers should be improved and better accommodation should be made available both for Income-tax assessees and for the offices. Each Income-tax Officer should be given a Stenographer and should be supplied adequately with stationery, and typewriters. Some offices should be supplied with adding machines, accounting machines, addressing machines, comptometers and such other mechanical aids as will speed up the work of the offices. 430, 433 & 434

188 Income-tax Officers should be encouraged to maintain conveyance and, with this end in view, they should be granted better facilities by way of conveyance allowance, etc. 437

Relations with the Public:

189 The Income-tax Officer must show by his conduct that he is not the taxgrabber he is described to be but a referee standing between the State on the one hand and the tax-payer on the other, with the sole idea and desire that both get a square deal. 443

If the Income-tax Officer sees to it that he is regular in attendance, prompt in attention, courteous in listening to grievances however frivolous in the manner of a skilful salesman, he will immediately find an encouraging response from the tax-payer. The Department on its part should judge the Income-tax Officer not on the number of heavy assessments he makes but on the number of unsuccessful appeals against his assessments, on the knowledge and understanding the Income-tax Officer shows and not on the pitch to which he raises his assessments, on the speed of his collections and not on the size of his paper demands. 445

Recommendation No.		Paragraph No.
190.	The experiment may be tried of appointing an Income-tax Officer attached to each Income-tax Circle to help the assessees in filling their Forms of Returns and otherwise assisting them in sloving their difficulties. Also, a Complaints Officer may be appointed and attached to the office of the Commissioner of Income-tax to inquire into public complaints about delays and discourtesy on the part of the establishment.	446
191.	Commissioners, Assistant Commissioners, Director of Inspection and the Member of the Board might advertise their tours and arrange them so as to be able to meet Associations and assessees more frequently.	447
192.	On the part of the public, Accountants, lawyers and business and professional associations should be able to contribute greatly to the awakening of the public conscience against evasion, if they will show by their action that an evader is not fit to hold any position of trust or honour in the community.	448

H. S. RAMASWAMI,
Secretary.
29-12-48.

(Sd.) S. VARADACHARIAR
(Sd.) G. S. RAJADHYAKSHA
(Sd.) V. D. MUZUMDAR

29-12-48.

APPENDIX A

(See Paragraph 22)

INCOMETAX INVESTIGATION COMMISSION

REPORT

in re certain proposed amendments to sections 34 *and* 46 *of the Indian Income-tax Act.*

A Memorandum explaining the need for certain amendments to the two sections was drawn up by the Commission (a copy of the same is attached to this Report as annexure A) on the 10th January 1948 and copies thereof were sent to about 60 institutions (Chambers of Commerce, Bar Associations, Societies of Accountants, etc.) with a request that the views of those bodies on the points dealt with in paragraphs 8, 9 and 11 to 17 of the Memorandum might be made available to the Commission not later than the 15th February 1948. Replies have so far been received from about 25 of these institutions. Three institutions have asked for further time to communicate their views. As all material considerations have been adverted to in one or other of the replies received and as the questions relevant to the amendment of section 34 have also been discussed at length in the Memoranda (which we have persued) submitted by public bodies at the time that the Income-tax Amendment Bill of 1938 was under discussion, we have not thought it necessary to delay this report any further.

2. The editors of the "Registered Accountant" unreservedly support the proposals for amendment. Some of the institutions addressed have given qualified support to the proposals, while some others have reserved their right to make comments after the amendments have been put forward in a concrete shape. Among those who are opposed to the amendment of section 34, many have stressed the danger of the abuse of the power under that section and the harassment that might be caused to the public by such abuse. They have insisted that the question was very fully considered in 1939, that the amendments then introduced were the result of a compromise between the Government and the opposition, that nothing has since happened to call for or justify a change in the law and that the decisions referred to in the Commission's Memorandum have only given effect to the policy and intention of the legislature. They have contended that the principle of finality of assessment should not be lightly ignored and have argued that if Income-tax Officers would only discharge their duties properly when making the first assessment, there would be little necessity for reopening the assessment. The argument winds up by saying that sufficient safeguards to protect the revenue and punish wrong-doers are provided by sections 35 and section 52 of the Income-tax Act. Strong remarks have been made in some of the representations against the ways of the Income-tax Department and its methods of dealing with the public and it has been urged that what is necessary is to raise the standard of efficiency of the assessing officers, to increase the number and to ensure that assessments are completed promptly and expeditiously. It is complained that the Department suffers from want of properly trained and equipped officers.

3. Many of the representations, however, disown any desire to espouse the cause of the dishonest assessee who does not keep proper accounts or will not produce them or deliberately evades the payment of tax. But it is urged that the assessee who has made a proper return and has disclosed all material information is entitled to protecion from further harassment. It has also been maintained that no assessment should be permitted to be reopened under section 34 merely on the ground that it has proceeded on an error of law or a mistaken interpretation of the facts or a mistaken application of the law to the facts. Some of the representation have conceded that in this last category

of case the law may, if such a step is considered necessary for the protection of the revenue, be amended so as to permit the Government to appeal against the order of assessment but they insist that the appeal, if any, should be preferred within the same limit of time as is allowed to an assessee. Alternatively it has been suggested that the power of revision formerly possessed by the Commissioner may be revised so as to enable him to correct such mistakes in the the Income-tax Officers's order. It has also been urged that it is unfair to permit an assessment to be reopened only in the interests of the revenue and it has been claimed that the principle of fairness and reciprocity should be recognised in such proceedings and that accordingly when the case is reopened the enquiry should not always be limited to the alleged new item but the assessee should be allowed to show that taking the case as a whole, he has been fully assessed or even over-assessed and that in the latter event he should be given refund of the excess tax paid.

4. To the proposed amendment of section 46, the opposition is not on the whole absolute. Some of the replies state that the problem of arrears and their realisation is not really serious. They point out that after the introduction of the provision in section 18-A for advance payment of income-tax there is likely to be little difficulty in the matter of realisation. It has also been pointed out that any notice by the Income-tax Officer to the banker, agent or debtor of the assessee to pay up the arrears of tax from out of monies due from him to the assessee may seriously affect the credit or business of the assessee. Among the replies which give qualified assent to the amendment, some suggest that notice by the Income-tax Officer of the kind contemplated should be issued only after he had given sufficient time to the assessee to pay up the tax. Some others suggest that it should be done only after giving notice to the assessee and hearing his objections. Others still advise that the notice should only operate as a freezing order prohibiting payment to the assessee and not as an order compelling payment to the Income-tax Officer. Attention has been drawn to the possibility of there being disputes as to the rights of the assessee to the funds alleged to be due to him from the third party or claims of others to the said funds and it has been urged that such questions should not be left to the Income-tax Officer's decision nor could payment be demanded from the third party before these questions were settled by competent authority.

5. We have given due and anxious consideration to these representations and to all aspects of the question. On the general question of the relations between the public and the Income-tax Department and on the complaints made against the Department this is not the proper place to make any comments. We hope to deal with the matter at a later stage. We are fully alive to the importance of respecting the principle of finality as far as possible; but, as pointed out in our former Memorandum, every system, of Income-tax law known to us recognises certain exceptions to this rule and the real question is as to the proper limits of those exceptions.

6. We are unable to agree with the argument that there is no need or justification for the amendment of section 34. The 1939 legislation (as interpreted by the Courts) is unduly restrictive and it does not give sufficient effect to the distinction between the case of the honest assessee who has disclosed all material facts and the abstructive or dishonest assessee who has kept back material information or even made false statements. In the English law, the power to make an additional assessment has been enacted in wide terms. The latest reported decision holds that an additional assessment can be made even when the authorities see reason to change their opinion as to the effect of facts already known or the earlier under-assessment was due only to a mistake of law; the learned Judge however recognised the existence of a conflict of judicial opinion on the point and the possibility of the Court of Appeal taking a different view (see Commercial Structures Ltd., v. Briggs 1947; 2. All E.R. 659 K.B.D.). Where the person chargeable has not delivered any statement

or has not delivered a full and proper statement, the real question under the English law is (as stated by the Codification Committee) whether in consequence of such failure the person chargeable has escaped being charged or has been under charged. Nothing turns on how the fact of under-assessment came to be discovered. This may be compared with the view taken by the Allahabad High Court in one of the cases referred to in our previous Memorandum where the learned Judges say "the mere fact that a discovery of under-assessment was made would not justify the Income-tax Officer in acting under section 34......although it may be said that there was a discovery of under-assessment, it could not be said that it was in consequence of something definite of which the Income-tax Officer had been informed". The Australian Act affords no protection to the tax-payer who has not made a true and full disclosure of all material facts. The Canadian Act enacts in general terms that notwithstanding any prior assessment or if no assessment has been made the taxpayer shall continue to be liable for any tax and to be assessed therefor and the Minister may at any time assess or re-assess or make additional assessments on any person for tax, interest and penalties (section 55) and it further provides that if any person omits to declare any dividend.........or other like income which on any enquiry by the Department of National Revenue or on information obtained from any person other than the tax-payer is subsequently ascertained to have been received such person may be assessed as if double the income so omitted from his return had been received. (section 83) The test which the Bombay High Court felt constrained to adopt on the interpretation of section 34 as amended in 1939, *viz.*, that Income-tax Officers can proceed to reopen assessment only if they have new information as to some fact or facts, was considered impracticable by the 1920 Royal Commission on the Income-tax Law in England. They said "in this connection we should like to make a brief reference to the proposal that was made to us that additional assessments should not be made except in cases where new facts are ascertained. We think it would be impossible to compose for this purpose any adequate definition of a new fact. Additional assessments are presumably not made unless there is good reason to believe that the true liability has not been covered by the existing assessment; the tax-payer has always the right of appeal; and if the previous assessment is after investigation found to be inadequate, we cannot see why the tax-payer should want to be excused from paying his just dues (paragraph 426)."

7. We, however, agree that it is possible to maintain that an assessment should not be allowed to be reopened under section 34 merely on the ground that the Income-tax Officer who made the assessment has misunderstood or misapplied the law or that a different view of the law or of the facts is possible. The proper remedy in such cases, if the Department considers the matter to be one of sufficient importance, is to allow the matter to be set right on appeal or in revision As we have already observed, many of the replies received by us recognise the appropriateness of such a course. The present Act has in principle recognised the need for such a method of correction in so far as it has provided for an appeal at the instance of the Commissioner against a decision of the Appellate Assistant Commissioner. So far as the Income-tax Officer's order is concerned, we find some practical difficulties in providing for an appeal against it at the instance of the Commissioner. We, therefore, prefer to give the Commissioner a power of revision. As the assessee may not be prepared to accept the Commissioner's order as final, we would give the assessee a right to take the matter on appeal to the Appellate Tribunal. Provision to this effect is made in a clause which we recommend may be inserted as section 33-B.

8. We also recognise the force of the argument that an assessee who has made a full and fair disclosure of all material facts to the Income-tax Officer

is entitled to all reasonable protection. A differentiation between him and an assessee who has not helped the Income-tax Officer is justifiable not merely in fairness to the former but also on the ground that the chances of income escaping assessment are much greater in the latter's case than in the former. A difference in the method of dealing with the two classes of cases may also help in the long run to convince assessees of the expediency of dealing fairly with the Income-tax authorities. But it seems to us going too far to assert that in the former category of cases there will be no reason or occasion at all for reopening the assessment. The Australian Income-tax Law to which reference has been made in some of the replies sent to us bases the Commissioner's right to amend the assessment on the circumstance that the assessee has not made a full and true disclosure of all material facts. Some judicial pronouncements in Australia seem to have held that the question of "disclosure" is mixed up with the knowledge and belief of the assessee at the time. It may accordingly turn out that there may be facts not known to him or not considered material by him and if such facts come to the knowledge of the Income-tax Officer subsequently, there is no reason why the assessments should not be reopened so as to provide for their being taken into consideration. We would accordingly recommend that the law should be so recast as to make a distinction between the two categories of cases and to impose a more stringent limitation on the right to reopen the assessment in cases where the assessee has made a true and full disclosure at the time of the original assessment.

9. In examining the claim for recognition of the principle of reciprocity, we must emphasise the fundamental difference between the position of the assessee and that of the Government which places the Government at a disadvantage, namely, that the assessee must be or is likely to be in possession of all material facts while the Government must depend to a large extent on what the assessee may choose to place before the Income-tax Officer. We are, however, prepared to recognise the fairness of providing for reciprocity where the assessee has acted fairly and honestly. Under the present law, courts have held that in proceedings under section 34, the enquiry should be limited to the item which is alleged to have escaped and the whole assessment should not be allowed to be reopened. The assessee has sometimes been allowed to show that the item in dispute has been included under some other head and has thus not escaped assessment but only included under a wrong head. But he has not been allowed to show that on the whole or under some other head he has been over-assessed. We are inclined to recommend some modification of this extreme view. But we are not prepared to accept the suggestion that proceedings under section 34 should also be made the occasion for a claim for refund by the assessee. Refund is independently dealt with in other sections of the Act and it will lead to confusion to mix up that question with section 34. It may, however, be recognised that if an assessee can show that though he had made a full and true disclosure of all material facts, he had wrongly been assessed on an amount or to a sum not lower than what he would have been justly liable for even if the items found to have escaped assessment had been taken into account, it would not be fair to impose any further liability upon him. Such a situation may for instance arise when he has been disallowed certain allowances to which he may be entitled under the law or he has been assessed at a higher rate than he may be rightly liable for. It is true that he could have appealed against the assessment in such cases, but it is conceivable that he did not think fit to spend time and trouble for preferring an appeal but yet when it is proposed to add to the charge imposed upon him, he feels that he has already more than paid what could justly be claimed from him even if the newly discovered item had been taken into account. If he had in fact taken proceedings under section 31 or 33-A,

the position would of course be different. The right to re-agitate must also be subject to the limitation that he cannot re-agitate matters concluded by orders under section 33-B or 35 or decisions under section 66 or 66-A. We note that a concession somewhat on these lines was recommended by the Income-tax Enquiry Committee, 1936, though the exact scope of their recommendation is not quite clear. They said, "Where in the same assessment there is under-assessment of one source of income and over-assessment of another, additional assessment should not be made under section 34 except to the extent, if any, by which the under-assessment exceeds the over-assessment". (Chapter XIV, Section 8 of the Report). We, however, think it right to limit this concession to cases where the assessee has made a true and full disclosure at the time of the original assessment. An assessee who has not done his duty at the time of the original assessment cannot justly claim that he has already been properly assessed. He was content to take the chance of his not being properly assessed and one can never be sure whether or not he had been properly assessed in the first instance.

10. By way of further safeguard to the public against the power under section 34 being abused, we would recommend that proceedings under section 34 should be taken only with the previous sanction of the Inspecting Assistant Commissioner. Such a provision will obviate the danger of the power being used capriciously and also meet the apprehension expressed in some of the representations that the widening of the power under section 34 may encourage Income-tax Officers to be careless at the time of the first assessment. Insistence on the previous sanction of the Inspecting Assistant Commissioner will ensure that the case will be brought to his notice and Income-tax Officers will not lightly take the risk of its being found out that they have not acted with due care and diligence at the time of the first assessment. There is also in our opinion some force in the argument urged by Mr. Chambers during the debate on the 1938 Bill that the reserve power under section 34 would be indirectly beneficial to the honest assessee because if the Income-tax Officer knows that he can go back for some years if he has missed anything he can afford to be more lenient and less suspicious in his treatment of the assessee and give him the benefit of the doubt. A redraft of section 34 calculated to give effect to the views above expressed with some minor changes is appended.

11. As regards section 46, we are not satisfied that there is no need for an amendment on the lines we have indicated in our Memorandum. The procedure of recovery through the Collector is inevitably dilatory. There is no basis or justification for the fears and doubts expressed in many of the replies to our Memorandum The very fact that the proposed amendment is to be introduced into section 46 of the Act will ensure that the power conferred thereby will come into operation only after the assessment had been completed and the time fixed for payment had expired The terms of the amendment we are recommending are calculated to empower the Income-tax Officer only to make a prohibitory order and not to compel a third party to pay. Any dispute as to the right of the assessee to the funds in the hands of the third party is also taken out of the cognisance of the Income-tax Officer and left to the decision of the Collector or of the Civil Court. A draft of the additions to be made to section 46 is appended.

Draft Amendments Suggested

I. Insert the following as section 33-B:—

"33-B. (1) The Commissioner may call for and examine the record of any proceeding under section 23, 27 or 34 of this Act and if he considers that any order passed therein by the Income-tax Officer is erroneous so far as it is prejudicial to the interests of the revenue, he may, after giving the assessee an opportunity of being heard and after making such enquiry as he deems necessary

cr causing such enquiry to be made, pass such order thereon as the circumstances of the case justify, including an order enhancing or modifying the assessment or cancelling the assessment and directing a fresh assessment.

(2) No order shall be made by the Commissioner under sub-section (1) of this section after the expiry of one year (two years?) from the date of the order sought to be revised.

(3) Against any order prejudicial to the assessee passed by the Commissioner under sub-section (1) of this section, the assessee may appeal to the Appellate Tribunal within 60 days of the date on which such order is communicated to him and such appeal shall be dealt with in the same manner as one presented under section 33(1).

Note.—The concluding words of sub-section (1) have been inserted to make it clear that decisions like XI. I.T.R. 340 and those referred to in it will not limit the powers of the Commissioner under this section. Under the older law, section 34 was assumed to cover even errors of law and the Courts seem to have thought that when specific provision had been made for the case in section 34, it could not have been intended to include it under section 33 also. That is not the scheme of section 34 now. Cases of error of law or erroneous inference of fact will no longer fall under section 34; the Commissioner must, therefore, have power to pass appropriate orders in such cases under section 33-B itself. That is also the reason why we have now provided for an appeal by the assessee to the Tribunal against the Commissioner's order

In clause (2), we leave it to the Government to decide whether the time-limit for revision should be one year or two years. At first sight, two years may seem a rather long period to keep the assessee in suspense. But it must be remembered that there is little likelihood of errors made by the Income-tax Officer being found out before the next inspection by the Inspecting Assistant Commissioner. At the earliest, the matter is likely to come to notice at the time of the next assessment, *viz.*, after a year's interval.

II. For section 34, substitute the following:—

"34 (1) If—

(a) the Income-tax Officer has reason to believe that by reason of the omission or failure on the part of the person chargeable to make a return of his income under section 22 or to disclose fully and truly all material facts necessary for his proper assessment, income, profits or gains chargeable to income-tax have escaped assessment for any year or have been under-assessed or assessed at a lower rate or been subjected to an excessive relief under the Act, or that loss or depreciation allowance has been wrongly computed, or

(b) though there has been no omission or failure as above-mentioned on the part of the person chargeable, the Income-tax Officer has in consequence of information in his possession, reason to believe that income, profits or gains chargeable to income-tax have escaped assessment for any year or have been under-assessed or assessed at a lower rate or been subjected to an excessive relief under the Act, or that loss or depreciation allowance has been wrongly computed,

he may, in cases falling under clause (a) above at any time within eight years and in any other case at any time within four years of the end of that year, serve on the person liable to pay tax on such income, profits or gains or the assessee concerned in such wrong computation and in the case of a company on the principal officer thereof a notice containing all or any of the requirements which may be included in the notice under sub-section (2) of section 22 and may proceed to assess or re-assess such income, profits or gains or re-

compute the loss or depreciation; and the provisions of this Act shall so far as may be apply accordingly as if the notice were a notice issued under that sub-section:

Provided

(i) that the Income-tax Officer shall not issue a notice under this sub-section except with the previous approval of the Inspecting Assistant Commissioner;

(ii) that the tax shall be chargeable at the rate at which it would have been charged had the income, profits or gains not escaped assessment or full assessment, as the case may be; and

(iii) that where the assessment made or to be made is an assessment made or to be made on a person deemed to be the agent of a non-resident person under section 43, this sub-section shall have effect as if for the period of eight years and four years a period of one year was substituted.

Explanation.—Production before the Income-tax Officer of account-books or other evidence from which material facts could with due diligence have been discovered by the Income-tax Officer will not necessarily amount to disclosure within the meaning of this section.

(2) Where an assessment is reopened in pursuance of a notice under sub-section (1), any assessee who has not impugned any part of the earlier order of assessment by proceeding under section 31 or section 33-A may claim that the proceedings under sub-section (1) should be dropped on his showing that notwithstanding his submission of a return and making a true and full disclosure of all material facts he had been assessed on an amount or to a sum not lower than what he would be rightly liable for even if the items alleged or found to have escaped assessment had been taken into account or the assessment or computation had been properly made;

Provided that in so doing, he shall not be entitled to reopen matters concluded by an order under section 33-B or section 35 or by a decision of the High Court or of the Privy Council under sections 66 and 66-A.

(3) No order of assessment under section 23 or of assessment or re-assessment under sub-section (1) of this section shall be made after the expiry, in cases falling under class (a) in sub-section (1) above of eight years and in any other case of four years from the end of the year in which the income, profits or gains were first assessable.

Provided that where a notice under sub-section (1) has been issued within the time therein limited, the assessment or re-assessment to be made in pursuance of such notice may be made before the expiry of one year from the date of the service of the notice even if such period should exceed the period of eight years or four years, as the case may be.

Provided further that nothing contained in this sub-section shall apply to a re-assessment made under section 27 or in pursuance of an order under section 31, section 33, section 33-A, section 33-B, section 66 or section 66-A."

(*Note.*—The section has been redrafted so as to give effect to the views indicated in our explanatory Memorandum. Both sub-section (1) and sub-section (2) logically carry out the differentiation suggested in the Memorandum between the honest assessee who has given every help and truly disclosed all materials before the Income-tax Officer and the dishonest or obstructive assessee who would not help the Income-tax Officer to conduct the assessment proceedings satisfactorily. So far as the honest assessee is concerned, it will be noticed that class (b) of sub-section (1) which deals with him differs but little from the present sub-section (1) of section 34. We have omitted

the word "definite" from the opening words of the present section (in consequence of definite information) because the word "definite" will bring in what is after all a question of degree or opinion and thus make the application of the section vary according as one person or another may consider a certain piece of information as definite or not. This will be a very undesirable test to prescribe in a section which has been construed by the Courts as the very basis of the Income-tax Officer's jurisdiction to reopen the assessment proceedings.* It will also be noticed that we have omitted the word "discovers" from the present section and substituted in its place the words "has reason to believe". This had to be done because the word "discovers" has been criticised in English cases as one of ambiguous significance. As a sufficient limitation is imposed by the opening words "in consequence of information, etc.", it will be sufficient to use the words "has reason to believe". Other changes in sub-section (1) are merely intended to make the section complete. For instance, we have also to cover cases not merely of under-assessment or escape of assessment but of determination of depreciation allowance or amount of loss to be carried over.

It will be noticed that class (a) is not limited to cases of fraudulent concealment. So long as escape or under-assessment has resulted from the assessee's non-submission of return or omission to make full disclosure, it makes little difference what the motive of the assessee in so behaving was. The natural inference from his omission is that he wished, if possible, to escape proper assessment. That is certainly fraud on the revenue law, whether it is morally fraud or not.

In the third proviso to sub-section (1), we have omitted the reference in the existing Act to income, profits or gains liable to assessment for a year prior to 1939, because there is no longer any occasion for that category of income to be dealt with. The first proviso embodies the condition relating to the previous approval of the Inspecting Assistant Commissioner.

The Explanation that we have added to sub-section (1) is important. Courts have some-times held that if in the papers produced before the Income-tax Officer there is information which if it had been ferretted out or properly pursued would have led to discovery of what is found later, the omission to make such a discovery must have been due to the neglect of the Income-tax Officer and the case would not, therefore, justify the reopening of the assessment. This view puts the revenue at a great disadvantage. It is common knowledge that accounts in this country are intentionally or unintentionally so badly kept that many material facts cannot be easily gathered therefrom. The Income-tax Officer has to do a large number of cases and there must be instances in which an ordinary inspection of the books will not enable him to discover or realise the bearing of certain facts. In other systems of Income-tax law, the assessee is expected to help the Income-tax Officer to understand the true situation and not merely leave him to make his own way. There is no reason why the same standard should not be adopted in this country.

Sub-section (2) has been introduced to give effect to the principle of reciprocity to the extent explained in our general Memorandum. We have excluded cases where the assessee has, in fact, questioned the assessment proceeding by an appeal before the Appellate Assistant Commissioner or by an application to the Commissioner (under section 33-A). Once he has taken such a step, there is no reason why we should not insist that he should have raised all the objections which he might have to the order as originally passed. We have, therefore, limited the concession to cases in which he has wholly acquiesced in the

* The annexed copy of a judgment of the Appellate Tribunal furnishes an illustration *vide* Annexure B.

original order. Even if he has acquiesced, there are cases in which an order adverse to him might have been passed under section 33-B as we have now proposed or section 35 or by the High Court or by the Privy Council on proceedings arising out of an appeal by the assessee against an order passed by the Commissioner under section 33-B. It is only right that the Income-tax Officer who is only a subordinate authority should not be permitted to reconsider points which might have been concluded by order of a higher authority. This is why such orders are saved by the proviso to sub-section (2).

In sub-section (3), we have introduced a proviso to meet cases where proceedings under sub-section (1) have been started late, though within the period of four or eight years allowed by that sub-section. It will be meaningless to insist that a proceeding which could be started towards the end of the fourth year should necessarily be completed before the expiry of the fourth year. In this limited class of cases, we have provided that proceedings so started should be completed within a year from the date of the service of the notice. The second proviso to sub-section (3) corresponds to the existing proviso to sub-section (2) of section 34; but to make the proviso logically complete, we have added a reference in it to sections 27, 33-A and 33-B because in the cases covered by those sections, it is quite possible that even normally the assessment proceedings may not be completed within the four years' limit

III. In section 46, provisions to the following effect may be inserted after sub-section (5) and before sub-section (6):—

"The Income-tax Officer may at any time or from time to time, by notice in writing (a copy of which shall be forwarded to the assessee at his last place of address known to the Income-tax Officer) require any person from whom money is due or may become due to the assessee or any person who holds or may subsequently hold money for or on account of the assessee to pay to the Income-tax Officer, either forthwith upon money becoming due or being held or at or within a time specified in the notice (not being a time before the money becomes due or is held) so much of the money as is sufficient to pay the amount due by the tax-payer in respect of arrears of income-tax and penalty or the whole of the money when it is equal to or less than that amount.

"The Income-tax Officer may at any time or from time to time amend or revoke any such notice or extend the time for making any payment in pursuance of the notice.

"Any person making any payment in compliance with a notice under this sub-section shall be deemed to have made the payment under the authority of the assessee and the receipt of the Income-tax Officer shall constitute a good and sufficient discharge of the liability of such person to the assessee to the extent of the amount referred to in the receipt.

"Any person discharging any liability to the assessee after receipt of the notice referred to in shall be personally liable to the Income-tax Officer to the extent of the liability discharged or to the extent of the liability of the assessee for tax and penalties, whichever is the lesser liability.

"If the person to whom a notice under sub-section has been sent does not make payment in pursuance thereof to the Income-tax Officer, further proceedings may be taken by and before the Collector on the footing that the Income-tax Officer's notice has the same effect as an attachment by the Collector in exercise of his powers under the proviso to section 46 (2)."

(This is intended to give effect to the views expressed in the Memorandum and no further explanation is called for.)

ANNEXURE A*

MEMORANDUM

The narrow construction placed by the courts in India on section 34 of the Income-tax Act since its amendment in 1939 is calculated to encourage the tax dodger and to cause considerable loss of revenue to the State. The section in its practical working also gives rise to some questions on which it seems desirable to make the law more definite and effective.

2. Before 1939, section 34 authorised assessment or re-assessment proceedings in all cases in which income, profits or gains had "for any reason escaped assessment, etc.". Some doubts and difficulties had been felt as to the precise implications of the word "escaped"; subject to this limitation, however, the power was very wide because of the generality of the opening words of the section. In the amended form (in force after 1939), section 34 confers the power "If in consequence of definite information which has come into his possession, the Income-tax Officer discovers that income, profits or gains chargeable to income-tax have escaped assessment etc.". The word "discovers" was taken from the corresponding provision in the English law. Its exact connotation cannot be said to have been established beyond doubt even in England. But the uncertainties arising from the retention of the word "escaped" and the introduction of the word "discover" have been overshadowed in practice by arguments as to the effect of the newly introduced opening words "in consequence of definite information which has come into his possession, the Income-tax Officer etc."

3. In a case which came before the Bombay High Court in September 1943, the learned Judges (Beaumont C. J. and Chagla J.) held that the opening words must have been introduced presumably out of a desire "to curtail the powers of the income-tax authorities." They were of the opinion that they could no longer follow the cases decided on the previous language of the section or even the English cases construing the word "discovers" in the corresponding English provision. The Chief Justice observed "To my mind, the expression 'definite information' denotes that there must be some information as to a fact". Chagla J. amplified the view by stating that "The information which must come into the possession of the Income-tax Officer must be information which was not in his possession at the time the old assessment was closed and came into his possession before the assessment was reopened under section 34. * * Correcting a mistaken view of the law is not definite information which comes into the possession of the Income-tax Officer within the meaning of the section. * * A mistake of law or misunderstanding of the provisions of the law is not covered by the language of the amended section. * * The discovery contemplated by section 34 must be the result of information about some fact or facts which were not present to the mind of the Income-tax Officer when he made the assessment."

4. The above restrictive view of the power under section 34 was followed in a judgment pronounced by the Allahabad High Court in Feburary 1945. Observing that the section as amended in 1939 was radically different from the section as it stood prior to that amendment, the learned Judges went on to hold that the amendment was designed to protect the subject against anything in the nature of an inquisition at the instance of the department founded on mere suspicion rather than on positive material. In a later case (decided in May 1946) in the same High Court, it was observed that the "mere fact that a discovery of under-assessment was made would not justify the Income-tax Officer in acting under section 34. * * The present is a case where although it may be said that there was a discovery of under-assessment it could not be said that it was in consequence of something definite of which the Income-tax Officer had been informed that the under-assessment was discovered." Then follow

---

* Vide para 1 of the Report.

observations which make the restriction on the Income-tax Officer's power much stricter. They said "As we have stated above, if discovery is the result of a further investigation or a closer study of the facts and circumstances of the case, such discovery would not be in consequence of definite information within the meaning of the section. * * It is worthy of note that by the amendment of 1939 the language of section 34 has been made more stringent and it would be only in a limited number of cases that action would be permissible under section 34".

5. It need hardly be stated that in this view of the law the Department's power to deal with escaped or under-assessed items of income is severely curtailed The last mentioned decision was commented on in a later decision of the same Court where the learned Judges pointed out that the earlier Judgment seemed to have proceeded on a misapprehension of the facts of the case and they qualified its effect to a certain extent by pointing out that section 34 would be satisfied if during the course of an enquiry for assessment of a particular year the Income-tax Officer came into possession of facts relating to a previous year leading him to the conclusion that some income had escaped assessment for the previous year. The rest of the statement of the law in the earlier Allahabad cases was allowed to stand.

6. Without multiplying instances, it may be stated that the view taken in most decisions as to the effect of the amendment made in 1939 is seriously prejudicial to the interests of the public revenue. It is open to question whether those responsible for the amendment intended or foresaw what has now been attributed to them. In the amending Bill all that was proposed was that for the words "for any reason" the words "the Income-tax Officer is of opinion that" should be substituted. This amendment was intended to remove the restrictive interpretation placed on section 34 by a judgment pronounced by the Calcutta High Court in February 1938. By that judgment the Calcutta High Court laid down that *before* taking action under section 34 the Income-tax Officer should hold a kind of *quasi*-judicial enquiry, giving the assessee an opportunity of being heard: this decision was reversed on appeal by the Privy Council but by that time the amending Bill had become law. The Select Committee which considered the Bill did not suggest the substitution of the words "in consequence of information which has come into his possession the Income-tax Officer discovers that" for the words "for any reason"; nor does the English Act on which the amendment was modelled contain such words. But during the debates in the Council Sir. James Grigg, in order to disclaim any intention on the part of Government to enable the Income-tax Officer to make "purely fishing enquiries with no basis at all", suggested the substitution of these words. However, the interpretation placed upon these words by the High Courts has in practice led to results which perhaps were not contemplated by Sir James Grigg; there is a wide gulf between the discouragement of fishing enquiries and the kind of restriction which the observations above extracted from the pronouncements of the High Courts impose.

7. Whether the member who then spoke on behalf of the Government intended or foresaw these consequences or not, it seems necessary to take steps to remedy the position if as the courts have held the section in its present form restricts the powers of the administration to the extent stated. It is possible to lay undue stress upon the finality of assessment proceedings once completed and the undesirability of permitting them to be reopened. The very existence of the power under section 34 which has its analogue in other known systems of income-tax law recognises that in the attempt to reconcile the interests of the taxpayer with the interests of the State and public revenue, it may be necessary to put limits upon the theory of finality. The only question, therefore, is what are the proper limits.

8. The honest taxpayer whose accounts are straight has little to fear. It is only the person who will not keep proper accounts or will not choose to

produce them that can ordinarily be subjected to proceedings under section 34. There is little to be said in favour of such a person as against the claims of the State to recover what is legitimately due to it under the law. The mere initiation of proceedings under section 34 cannot even in such cases be deemed to be a great hardship except to the extent that the assessment proceedings are reopened. The assessee has still available to him all the safeguards and remedies by way of enquiry, appeal etc., provided to every taxpayer. It is common experience, especially in cases where the accounts are not properly kept, that certain facts or aspects are realised more clearly when the accounts come under examination for a later year. If facts thus coming to light indicate that any items have escaped assessment or have been under-assessed in a previous year, the subject can have no reason to complain if such defects are rectified by proceedings under section 34. It is not always possible to say how much was present to the mind of the officer who examined the accounts in the previous year. The mere fact that the books were before him cannot always be taken to imply that nothing could have escaped his attention.

9. Even in cases where the non-assessment or under-assessment was due to a mistake in law, there appears to be no justification for depriving the State of its dues when the mistake is discovered. The sound principle would seem to be that indicated by the Privy Council as the true meaning of section 34 as it stood before the amendment *viz.*, "that the Income-tax Officer on the information which he has before him and in good faith considers that he has good ground for believing that the assessee's profits have for some reason escaped assessment or have been assessed at too low a rate". As pointed out in the latest Allahabad decision, it may not be open to the Income-tax Officer to *compel* the assessee to produce his books even for the purpose of reaching this tentative conclusion. But that is different from saying that the requisite information may not be derived from the assessee's books even when they are *voluntarily* produced before the officer in connection with assessment proceedings relating to a subsequent year.

10. The English Committee on the Codification of Income-tax Law recommended that for the word "discovers" in section 125 of the English Act it would be preferable to substitute the phrase "comes to the conclusion". The section would then run "If as respects any year of charge the Inspector comes to the conclusion that any income which ought to have been assessed, etc.". This is substantially the same as the condition suggested by the Privy Council in the Calcutta case. The corresponding provision in the Australian Income-tax Assessment Act, 1936, makes the amendment of the assessment depend on whether or not the taxpayer has made to the Commissioner "a full and true disclosure of all the material facts necessary for his assessment and there has been an avoidance of taxation". This certainly affords no help to the taxpayer who keeps back his account books or conceals any information from the taxing authority. If he is guilty of non-disclosure or concealment, it comes with ill grace from him to call upon the Income-tax Officer to state how he discovered that there has been an under-assessment or omission to assess.

11. The question of the course to be followed where there has been no attempt at suppression or concealment but there nevertheless has been under-assessment or omission to assess by reason of oversight on the part of the Income-tax Officer or mistake of fact or even a mistake of law is one of greater difficulty. Few will maintain that a mere change of opinion on the same facts would justify the reopening of an assessment. But the position is not the same where there has obviously been a mistake, whether it be a mistake of fact or a mistake of law. There is hardly any place here for the application of the principle that everybody is presumed to know the law. On the other hand, it is a well-established principle that no public servant can prejudice the interests of the State by acting in contravention of law. If cases of mistake of fact or

mistake of law cannot be remedied by proceedings under section 34, it may be necessary to consider whether it will not be proper to provide the Crown with a remedy by way of appeal against the decision of the Income-tax Officer in such cases; or it may be necessary to revive the power which the Commissioner formerly had to set aside the Income-tax Officer's order on revision and direct him to make a proper assessment.

12. In cases in which the assessee is believed to have concealed the particulars of his income or deliberately furnished inaccurate particulars, the Income-tax Officer is given eight years from the end of the assessment year to serve a notice under section 34. Sub-section (2) of the section fixed a time limit within which the assessment or re-assessment should be made. Cases of concealment or submission of wrong particulars are here described by reference to clause (c) of section 28, sub-section (1). There is reason to apprehend that this *referential description* in sub-section (2) may give rise to difficulty. In construing section 28 certain courts have held that the original assessment proceeding and the subsequent reassessment proceeding are two different proceedings and that concealment or inaccurate information in the course of the first proceeding cannot be punished in the course of the second proceeding. If the reference to section 28 (1) (c) in sub-section (2) of section 34 is to be interpreted in the light of this construction of section 28, the sub-section may become unintelligible. The reference there is obviously to the concealment or furnishing of inaccurate particulars in the course of the original assessment proceeding The language would, therefore, appear to require some modification to make this meaning clear.

13. The proviso to sub-section (2) removes the time-limit in cases where an assessment is made *in pursuance of* an order under section 31, section 33, section 66 or section 66-A. The expression "in pursuance of" implies that the re-assessment is one made *to give effect to* the appellate order. It may, however, sometimes happen that as a consequence of an order of the appellate or provisional authority or of the High Court a person who had been originally assessed by the Income-tax Officer may be exonerated. The question will then arise whether proceedings should not be permitted to be taken against any other person who could have been assessed if the Income-tax Officer had not thought that the person who was subsequently exonerated was the person liable. The complicated provisions of the law certainly give much room for honest doubts and differences of opinion as to the person liable to be assessed or as to the manner in which a person is to be assessed. If the Income-tax Officer has proceeded on a view which is subsequently held by higher authority to be erroneous there is no reason why that should be made a ground for the person really liable escaping assessment or for the assessment not being made in the proper manner. It would appear necessary to make some provision for such contingencies.

14 It may also happen that proceedings under section 34 are initiated in time but they may ultimately fail on technical grounds, *e.g.*, the want of proper notice or the absence of jurisdiction in the particular officer who initiate the proceedings Here again, there would not appear to be much justification for the person liable being allowed to escape assessment on the ground of lapse of time.

15. Sub-section (2) of section 34 gives the same period for completion of proceedings as that prescribed for their initiation, *e.g.*, four years generally and eight years in special cases. This may not always allow sufficient time for completion of proceedings, especially in those cases where proceedings are started towards the close of the limitation period. It would, therefore, appear desirable that an additional period of a year or two should be available to the Income-tax authorities for completion of proceedings.

16. In the proviso to sub-section (2), a reference to section 33-A may also have to be added because under section 33-A the Commissioner may in certain

circumstances make an order which an appellate authority could have made and which may involve reopening the assessment.

17. An amendment to section 46 of the Act seems necessary to facilitate realisation of the tax and in some instances even to ensure that recovery proceedings are not rendered infructuous by the assessee. Under the law as it now stands, the Income-tax Officer must seek the aid of the Collector to recover tax in arrears except in cases falling under sub-sections (3) and (4) of section 46. Even under these two sub-sections, the procedure is not always simple. Other systems of law permit the taxing authority to serve a notice upon persons who may hold or who may be expected to come into possession of monies belonging to the assessee, *cf.* section 72 of the Canadian Income War Tax Act of 1917 (Revised Statutes of Canada. Volume II, page 2160 and section 218 of the Australian Income Assessment Act. 1936). On receipt of such notice, the person holding the money is restrained from paying it over to the assessee without satisfying the tax claim. The principle of these provisions is given effect to in sub-section (5) of section 46 of the Indian Act but this provision is limited to "salaries". It frequently happens that monies lying to the credit of a person with another or with his bankers can be made available if the fund can be got at without delay but they may be lost by reason of dilatory procedure as the assessee will in the meanwhile be able to withdraw the money. It might, therefore, be desirable to extend the principle of sub-section (5) of section 46 to other classes of funds held by any person, authority or institution to the credit of or on behalf of an assessee.

ANNEXURE B

(See item II of Amendment suggested in Report.)

IN THE INCOME-TAX APPELLATE TRIBUNAL

Before

I. T. A. Nos. and of 1946-47.

(Assessment years 1939-40 & 1940-41.)

Messrs. A. Firm—Appellant

versus

The Income-tax Officer—Respondent.

Appellant by..................

Respondent by..................

ORDER

Both these appeals raise the question of the validity of action under section 34. The relevant assessment years are 1939-40 and 1940-41. The assessee carries on a business in caps. etc. in Bombay. The original assessment for the year 1939-40 was completed on 24th June 1940 and the original assessment for the year 1940-41 was completed on 29th February 1941. On 10th November 1942 the Income-tax Officer issued notices under section 34 in respect of both the years and supplementary assessments were made on the assessee on 15th June 1943 in respect of both the years. In the supplementary assessment for 1939-40 the Income-tax Officer has, at the beginning of his order, stated:—

"In this case action under section 34 was taken as it was ascertained during the course of the assessment proceedings of 1941-42 that the assessees had debited some items to the trading account which

did not represent genuine purchases and also had claimed interest payments which were against benami accounts and which accounts were not genuine."

In the supplementary assessment order in respect of 1940-41 the Income-tax Officer states:—

"In this case action under section 34 was taken as it was definitely ascertained that the income of the firm assessable to income-tax was under-assessed."

The assessee questions the legality of the action under section 34 in respect of both the years.

2. Under section 34, an Income-tax Officer may proceed to assess or reassess if in consequence of definite information which has come into his possession he discovers that income, profits or gains chargeable to income-tax have escaped assessment in any year or have been under-assessed or have been assessed at too low a rate That section requires that, before action under that section can be taken, the Income-tax Officer must be in possession of definite information and that in consequence of that information he has discovered that income, profits or gains have escaped assessment. There is, however, nothing in the section which compels the Income-tax Officer to record that information before action is taken under it.

3 For both the years under consideration, it is conceded that before the notice under section 34 was issued on 10th November 1942 there is no record of the information on the basis of which the Income-tax Officer proceeded to issue notices under section 34. The case of the assessee is that the Income-tax Officer had no information at all, much less "definite information" before notices under section 34 were issued. *Per contra* it is contended by the Department that though there was no written record of the information which the Income-tax Officer had, nevertheless the Income-tax Officer was in possession of definite information which led him to the reasonable belief that income had escaped assessment. In the absence of any record prior to 10th November 1942 showing what was the information, I have necessarily to examine the surrounding circumstances and determine whether in the light of the evidence afforded by those circumstances, I can reasonably come to the conclusion that the Income-tax Officer had definite information within the meaning of section 34 prior to issue of the notices under that section. According to the Department, as stated by the Departmental Representative, the definite information consisted of—

(i) Bogus purchases from E. & Co., were recorded in the books of the assessee;

(ii) Assessee and E. & Co. had a joint venture and profits therefrom had been suppressed; and

(iii) No stocks of the joint venture belonged to E. & Co.

At the time of the reassessment under section 34 it would appear that the assessee did not raise any objection to action under section 34 being taken. He however raised that contention in the appeals preferred to the Appellate Assistant Commissioner against the orders of reassessment. At the time of the appeals before the Appellate Assistant Commissioner, the Income-tax Officer who made the reassessments under section 34 appeared and explained to the Appellate Assistant Commissioner what according to him was the position prior to the issue of the notices under section 34. The Income-tax Officer stated that on 19th June 1942 one Mr. E. who was a partner in the firm of E. & Co. appeared before him and gave him certain information. That information

is set out in the Appellate Assistant Commissioner's order in paragraph 3 and is as follows:—

"(i) That the firm of Messrs. A. did joint venture business with Messrs. E. & Co. in the years 1933 and 1934 and the net profits of the venture were about four lakhs of rupees. As the whole of the Business was done in the name of A. Firm the latter did not pay anything to Messrs. E. & Co. Mr. E. is said to have stated that he was in Europe making purchases and sending goods to Bombay. He further stated that the whole of the above amount earned in the joint venture was invested in their business by the appellants in Benami names and it was shown that the appellants have been working on borrowed capital. He also further told the Income-tax Officer that the appellant firm has been making huge profits but the profits are reduced by entering bogus purchases and claiming bogus expenses. He is said to have further informed the Income-tax Officer that the appellants reduced profits by writing bogus bad debts, for instance, he said that the appellants wrote off the bad debt of Mr. S. during the year of account even though Mr. S. is working with the appellant as a partner in A. Firm. Further, according to him, the interest payments claimed were not genuine claims. He also referred to the High Court decree in the suit filed by Messrs. A. Firm against the Firm of Messrs. E. & Co."

4. It may be noticed that that statement was made sometime in 1946, more than three years after the notices under section 34 were issued. The assessee in his grounds of appeal before the Tribunal denied categorically that any such statement was made by the Income-tax Officer to the Appellate Assistant Commissioner. Mr.................. who appeared for the assessee before the Appellate Assistant Commissioner and who instructed counsel at the hearing before the Tribunal also denied that the Income-tax Officer made any such statement to the Appellate Assistant Commissioner. It seemed to us in those circumstances that it would be desirable to send for Mr. K., the Income-tax Officer concerned, and ascertain from him whether he made any statement. Mr. K. attended before us and said that in the course of the argument he did put forward what is stated in the above paragraph as definite information which was given to him by Mr. E. on 19th June 1942. It does not appear that the Appellate Assistant Commissioner recorded any formal statement of the Income-tax Officer was asked to explain how more than three years after the events with which we are concerned, he was able to remember the date and Income-tax Officer. I have however no doubt that what is set out by the Appellate Assistant Commissioner in paragraph 3 of his order is based on what was mentioned before him at the time of the hearing of the appeal. The the substance of the information given to him by Mr. E. on that date. His answer was that he furnished that material to the Appellate Assistant Commissioner after referring to the records. The date 19th June 1942, according to him, was remembered because on the receipt of this information he sent for the file of the assessee in which assessment was pending for 1941-42 and directed an appointment to be given immediately. The order sheet for 1941-42 under date 19th June 1942, contains the following—

"The return is received long ago, why no appointment is given up to now? Grant appointment at once."

It is not improbable that the Income-tax Officer was able to mention 19th June 1942 by reference to the entry in the order sheet. Furthermore, as he was appearing before the Appellate Assistant Commissioner in support of his order, he must have examined the entire record relating to this matter. The position is however different when I come to examine the substance of the

nformation which he is said to have given to the Appellate Assistant Commissioner. Barring the statement of Mr. E. which was recorded subsequent to the issue of the notice under section 34, there is nothing on record giving any indication as to what information was received by the Income-tax Officer prior to the issue of the notices under section 34. Keeping in mind the contents of the statement made by Mr. E. and recorded by the Income-tax Officer on 12th November 1942, it seems difficult to believe that the Income-tax Officer could have had such a clear recollection of the information given to him in June 1942. The next event to be noticed is that on 11th September 1942 the Income-tax Officer directed issue of summons under section 37 to E. & Co. at once for appearance with accounts for 1938 and 1939. But Mr. E. was apparently out of Bombay and that summons was not complied with. On 17th September 1942 a summons under section 37 was issued to the assessee for the production of the accounts of S. 1997 corresponding to 1941-42 and also a copy of the consent decree in the suit between the assessee and E. & Co. A medical certificate stating that one of the partners was ill was produced. Thereafter on 23rd September 1942 another summons under section 37 for appearance of the assessee on 1st October 1942 with the accounts of S. 1990 and 1997 and the consent decree was issued. The assessee did not produce either the accounts or the consent decree. It is obvious the assessee was evading the production of the account and the consent decree. On 26th October 1942 a second summons under section 37 was issued to E. & Co. for appearance on 30th October 1942, with the accounts for 1938 and 1939. It is stated that on that day Mr. E. appeared. He did not produce the books but made a statement that his firm had not sold any goods worth Rs. 2,000 and is said to have given the Income-tax Officer the whole history of the appellant firm as to how the latter are connected with various other firms and how they are manipulating the accounts by putting in bogus purchases and claiming bogus payments. It is further stated that the production of the books as well as recording of statement was at his (Mr. E.'s) request postponed for a fortnight. The case file does not indicate any reason for the non-recording of Mr. E.'s statement on 30th October 1942. On 7th November 1942 the entry in the order sheet reads:—

> "Issue notices under section 22(2) read with 34 for 1939-40 and 1940-41 at once to the firm and the partners".

As stated already, the notices were actually issued under section 34 on 10th November 1942. On 12th November 1942 Mr. E. appeared before the Income-tax Officer and his statement as recorded is as follows:—

> "The firm of Messrs E. & Co. have sold goods as detailed below during the periods of 24th October 1938 to 11th November 1939 and 12th November 1939 to 30th October 1940 which periods correspond to the Hindu Samvat years 1995 and 1996 to Messrs. A. Firm."

The total of the sales for 1995 was Rs. 1,002-10-6 and for 1996, Rs. 2,552-12-6. No other goods are sold by the firm of E. & Co. to Messrs. A. Firm during the periods mentioned. I further state that no goods are sold to Messrs. A. Firm by me in my personal capacity during these periods. I further state that there were no goods belonging to our firm or to me personally kept in the godown of Messrs. A. Firm to be purchased by them for want of delivery not being taken of the goods sold to Messrs. E. & Co. If the said Messrs. A. Firm have shown any amounts credited to our accounts, they may be part of the profits falling to our share from the joint pool business done with Messrs. A. Firm in 1933, the accounts for which they have suppressed from us all along and as to which they have misled us."

5. That is practically all the material on record bearing on the question under consideration. It has to be first noticed that no explanation has been

given as to why when on 19th June 1942 Mr. E. came to the Income-tax Officer and gave information regarding the conduct of the assessee a statement was not recorded by the Income-tax Officer on that date itself. It is somewhat curious that the Income-tax Officer should have thought of recording the statement of Mr. E. two days after the issue of the notices under section 34. It is not easily discernible what was the purpose that was intended to be served by the statement of Mr. E. being recorded two days after the notices had been actually issued. There is another interesting feature about the statement of Mr. E. If the Income-tax Officer could remember in 1946 several points on which Mr. E. gave information to him in June 1942 why did he not think it necessary to include in the statement recorded on 12th November 1942 information other than that relating to the sale of goods by Mr. E. to assessee and the denial by Mr. E. that goods belonging to his firm or to himself were kept in godown of A. Firm? Mr. E. in that statement said nothing about profits earned in the joint venture being invested in benami names and the appellant was showing in his books that he is working on borrowed capital. He said nothing about writing bogus debts nor about a bad debt of Mr. S being written off improperly.

6. There cannot, however, be any doubt that by at least 11th September 1942 the suspicions of the Income-tax Officer in respect of assessments for 1939-40 and 1940-41 had been aroused. Otherwise he would not have issued summons on that day to E. & Co., under section 37 for production of books for 1938 and 1939. But mere suspicion is not enough for the purpose of taking action under section 34. He must have definite information prior to the issue of the notices. He had not examined the books either of Mr. E. or of the assessee relating to these two years because they were not produced before him. Assuming that owing to good and retentive memory the Income-tax Officer was able to recollect what was actually stated to him by Mr. E. on 19th June 1942 and he gave a gist of that information to the Appellate Assistant Commissioner, as recorded by him, we have to consider whether there is any other information which the Income-tax Officer had in addition to the information contained in the paragraph extracted above. The Departmental Representative quite candidly stated that the Income-tax Officer had no information beyond what was stated in that paragraph. The information consisted of: (1) the assessee and E. & Co. did joint venture business in the years 1933-34 and the net profits of the venture were Rs. 4 lakhs; (2) assessee did not pay any part of these profits to E. & Co.; (3) the entire profit earned in that joint venture was invested in the business of the assessee in benami names and assessee showed that it was working on borrowed capital; (4) assessee has been making huge profits but profits are reduced by entering bogus purchases and claiming bogus expenses; (5) assessee reduced profits also by writing off bogus bad debts; (6) the bad debt of Mr. S. was written off; and (7) interest payments claimed were not genuine claims.

7. In the first place it is doubtful if the information set out above can be said to be definite. In fact what is stated is more in the nature of allegations than information. Assuming that it is definite information, the section further requires that in consequence of that information the Income-tax Officer has discovered that income has escaped assessment. In other words, the information must lead to a reasonable conclusion that income has escaped assessment. It is to be remembered that prior to issue of notice Mr. E. did not produce even a scrap of paper in support of his allegations and the Income-tax Officer had not satisfied himself that the statement made by Mr. E. was worthy of the least credence.

Section 34, as amended, will not permit an Income-tax Officer to act on vague statements made by parties, interested or otherwise, and without the

information before him leading to a *prima facie* conclusion that income has escaped assessment. In my view the Income-tax Officer at the time when he issued the notices under section 34 did not have before him definite information in consequence of which he discovered that income had escaped assessment in the two years.

8. I arrive at this conclusion not without some regret because it may be that the Department has a very good case on the merits. This result was not inevitable. The Income-tax Officer had all the time between June and November 1942 to deal with this matter in a more methodical manner. If that had been done, it is not improbable that there would have been no scope for any controversy relating to the applicability of section 34.

9. The appeals are allowed and the supplementary assessments under section 34 for both the years are set aside.

The 4th February 1948 *Judicial Member*

It is not without hesitation that I have come to the conclusion on purely technical grounds that the appeals should be allowed and the supplementary assessments under section 34 for both the years should be set aside. In this connection I am respectfully in accord with the view expressed by the Judicial Member that the Department's case is probably good on merit—as far as the actual assessments are concerned.

2. What exactly led to the issue of notices under section 34 cannot be ascertained from the record. Under the section as it now stands the Income-tax Officer has to discover that income, profits or gains chargeable to income-tax have escaped assessment in any year, or have been under-assessed, or have been assessed at too low a rate, or have been the subject of excessive relief under this Act. The discovery of the Income-tax Officer must be the result of definite information which has come into his possession. *The information which must come into his possession must therefore be infomation which was not in his possession at the time the old assessments were closed and came into his possession before the assessments were reopened under section 34 of the Act.* It was suggested that it was not statutorily laid down that such information should be specifically recorded. That may be so but in that event it must become difficult to establish that proceedings under section 34 were appropriately initiated. Even on a review of the circumstances under which notices under section 34 were issued it was not possible to escape the conclusion that the Income-tax Officer had no definite information, resulting in his discovering that income had escaped assessment.

3. I have been unable to attach much importance to the statement of Mr. E. as it was recorded subsequently to the issue of notices under section 34.

4. All that I gather from the circumstances and order of the Income-tax Officer is that prior to the issue of notices under section 34 his suspicions were aroused by vague and indefinite information that possibly came into his possession and he therefore pursued the matter and made sustained endeavours to obtain definite information, but I cannot help thinking—I am obliged to say it—that he had no definite information within the meaning of section 34 *preceeding the issue of notices under section 34.*

The 10th February 1948 *Accountant Member*

Appendix B

(*See* paragraph 23)

OFFICE OF THE INCOME-TAX INVESTIGATION COMMISSION,

MINISTRY OF FINANCE (REVENUE DIVISION)

New Delhi, the 29*th May*, 1948.

To

Sir,

A part of the duty assigned to the Commission under section 3 of the Taxation of Income (Investigation Commission) Act, 1947, is to investigate and report to the Central Government on all matters relating to taxation on income, with particular reference to the extent to which the existing law relating to and procedure for assessment and collection of such taxation is adequate to prevent the evasion thereof. Although the words "on all matters relating to the taxation of income" would seem to suggest a very wide scope for the inquiry, the Commission read them in the light of the preamble to the Act which refers to "the purpose of ascertaining whether the actual incidents of taxation on income is and has been in recent years in accordance with the provisions of law". They are therefore principally concerned with topics of legal avoidance, evasion and the causes which lead to the tax not being levied or collected through defective machinery of the department. The Commission have therefore prepared a questionnaire, copy of which is enclosed herewith, and they will be grateful to have your views the views of your association on the points mentioned in the questionnaire.

The Commission will be glad if the views are communicated so as to reach this office on or before the 31st July, 1948.

Yours truly,

H. S. RAMASWAMI,

Secretary.

(By order of the Commission).

QUESTIONNAIRE

(Except when otherwise stated, the sections referred to in the Questionnaire are the sections of the Indian Income-tax Act.)

I. Residents and non-residents

1. Is it necessary or justifiable to retain in the statute the special group of provisions relating to the category described as "Not ordinarily resident"?

2. Under the existing law, a non-resident is not liable to pay tax on profits brought into or remitted to British India during the particular year in which he claims the status of a non-resident, although in preceding years he might have been a resident and he may resume the status of a resident in the very next year after he has brought his foreign earnings into the country. To meet such a case, would you approve of the introduction of a category of "ordinarily resident" defined in positive terms analogous to the provisions suggested by the English Codification Committee with regard to persons styled as "principally resident", or would you suggest that even non-residents should be declared as assessable in respect of profits brought into or remitted to British India?

3. What suggestion would you make to improve the means available to the Income-tax Department for ascertaining the total income in the case of non-residents?

4. The Act makes no express provision in respect of cases where a non-resident has businesses or business connections through more than one person in different parts of India. It may be open to question whether any one of such persons can be treated as assessee in respect of profits made in the business carried on by or through another such person in another part of the country. There can be no doubt that the non-resident himself can be assessed on the aggregate of profits made in all the places. Will it not therefore be desirable to provide that for convenience of realisation, the Income-tax authorities can treat any one of these persons as the assessee (under sections 42 and 43) in respect of the profits made by or through all the agents of the non-resident? If this view is adopted, provision will also have to be made for retainer of the necessary sum by the agent so selected.

II. Hindu Undivided Families

5. What changes would you suggest in the law relating to the assessment of the income of a Hindu undivided family to income-tax? Would you make any difference between a family governed by the Dayabhag law and a family governed by the law of the Mitakshara? Would you suggest any modification with reference to the test laid down in the Act for determining the residence of a Hindu undivided family in so far as it is linked up with the residence of the Karta which may change from time to time and may not always have a relation to the situs of the family properties?

III. Companies and Firms

6. Do you think that the provision made in section 4A (iv) (c) declaring a foreign company (that is a company having its head office outside India) to be resident in British India in respect of any particular year, if its income arising in British India during that year exceeds its income arising without British India, requires any modification, as it may result in bringing into account in Indian taxation losses sustained by the foreign company abroad? Do you think that the situation could be met by a provision as to the

manner or circumstances in which the foreign losses of such a company should be dealt with for the purpose of India taxation, or would you suggest any other change in the Act so far as it relates to taxation of foreign companies?

7. A complaint has been made that firms avoid super-tax by converting themselves into Companies, particularly private limited companies. Are you in favour of the imposition of a graduated super-tax properly so called on companies in place of the existing Corporation Tax which is only a flat rate but which is not subject to any minimum? If the answer is in the affirmative, do you think that a shareholder to whom a company pays dividends should be entitled to the same treatment in respect of super-tax as he receives with regard to income-tax under section 49B?

8. Do you think it necessary or expedient to treat private limited companies as incorporated bodies for the purpose of income-tax assessment, or would you prefer to see them assimilated to partnerships which in substance they are? If the existing provisions relating to private limited companies are to be retained, have you any modifications to suggest either in the definition of such companies for the purposes of the Income-tax Act or in any other respect?

9. Is it not desirable to check the practice of converting each venture of practically the same set of persons into a separate private company merely with a view to escape higher rates of taxation? If so, what will be the best method of doing it? Similarly, how is it possible to checkmate the practice of creating nominal intermediate concerns or taking or introducing nominal partners frequently minors, women and dependents for the same purpose? Would it not be desirable to have provisions in the Income-tax Act similar to sections 10 and 10A of the Excess Profits Tax Act?

10. What steps can you suggest to prevent *ex post facto* creation of evidence in favour of an earlier partnership to escape higher rates of taxation in respect of periods when large profits had been made? Do you think it desirable to enact in this country a provision similar to that in England under the "Registration of Business Names Act", compelling the proprietors of businesses to register the names of their businesses, the persons interested therein, the place or places where they are carried on, within a specified period after the commencement of the business? The provisions of the Indian Partnership Act relating to Registration have not achieved the purpose which it was hoped they might achieve. Section 26 of the Incmoe-tax Act leaves the matter to the option of the assessee and registration may take place long after the commencement of the alleged partnership. Compulsory registration will obviate a great deal of uncertainty and unnecessary enquiries as to the true ownership of the business, both in the interest of the public and for the purposes of taxation.

IV. Mutual Associations

11. Would you recommend any change in the law relating to mutual associations making profit out of commercial activities?

V. Collection and information at source

12. Is there any scope for extending the provisions of the Act relating to (a) deduction of tax at source, and (b) furnishing of information as to payments of rents, etc., by the person paying?

13. Would you recommend the insertion in the Act of a provision obliging companies to deduct super-tax from dividends payable to all non-resident shareholders even when the amount of dividend is below the maximum amount not chargeable to super-tax? The total world income of a non-resident shareholder may well exceed the maximum amount not chargeable to super-tax or he may

draw dividends from more than one company and the aggregate of such dividends even in India itself may exceed such maximum. If you are in favour of such a provision, what do you think should be the rate for the levy?

VI. Advance payment (interest on)

14. Is there any justification for differentiating between cases falling under section 18 and cases falling under section 18A by allowing interest on advance payments only in respect of the latter, pre-payment or pre-collection being a matter of convenience in both classes of cases?

VII. Computation of income

15. Can the provisions of section 10 (4) (b), which are limited to firms, be extended *mutatis mutandis* to private limited companies and associations generally?

16. Have you any objection to the introduction of a provision on the lines of section 108 of the Australian Act declaring that any distribution out of income by way of advances or loans made by a private company to its shareholders shall be treated as dividend?

VIII. Deductions and allowances

17. In view of the provisions of section 14, sub-clause (2) (c), excluding from income-tax income, profits or gains accruing or arising within an Indian State (unless received or brought into British India), should not proviso 1 to section 24 be so worded as to make it clear that losses sustained in an Indian State should not be taken into account so as to reduce the taxable amount of profits actually made within the Indian Union during the same period, except in so far as the profits made or losses incurred in the Indian States may be relevant to the determination of the rate of tax which will depend upon the total world income?

18. Would it be possible to meet the complaint of the public that Income-tax Officers are taking an unduly narrow view in accepting as expenses incurred for business purposes only a small proportion of the sums proved to have been spent in the maintenance of motor cars, giving entertainments and other attractions for the benefit of customers?

19. What steps should be taken to checkmate attempts to show items of capital expenditure on plant, machinery and buildings as no more than cost of ordinary repairs and maintenance?

20. Could not section 10 (2) (iii) be so worded as to make it clear that the interest paid on capital borrowed for business can be regarded as an admissible deduction only so long as and to the extent to which the amount borrowed is used for business? The mere fact of initial borrowing for business cannot be the test independently of how the amount borrowed is subsequently used.

21. Section 10 (2) (vi) provides generally for depreciation allowance in respect of machinery, etc. A question has arisen as to whether full allowance for the year or only proportionate allowance should be given in cases in which—

(a) the machinery is not worked for the whole year, or

(b) the assessee is not the owner of the machinery for the whole year.

Should not a provision or proportionate allowance only be made to meet such cases?

IX. Stock valuation

22. Will it not be expedient to empower the Central Board of Revenue to provide by rules the methods by which and the principles according to

which stock valuation should be made for arriving at profits for the purpose of taxation?

X. Usufructuary mortgages

23. Will it not be desirable to make a specific provision in the statute itself as to the manner in which income derived by a mortgageee in possession of agricultural land should be dealt with for income-tax purposes? If so, on what lines do you think such legislation should proceed having regard to the possible varieties of arrangements under which the mortgagee may be in possession?

XI. Premium on leases

24. In view of the growing practice of receiving premia—by whatever name called—in connection with leases, would it not be right to provide in the Act itself that such premia should be treated as taxable income either in the year of receipt or by distributing the same over the period of the lease? (Compare Sections 83 and 84 of the Australian Act and the English decision in Abbot *vs.* Davies, 11 T. C. 575).

XII. Unclaimed balances

25. What do you think of a proposal that unclaimed and waived surpluses to the credit of customers, suppliers and employers to the extent they are made up of deductions or allowances previously allowed as admissible expenditure for the purpose of assessable income, but not fully expended or paid in actual fact for over three years, should be deemed as profits on the analogy of the proviso to Section 10 (2) (11) in respect of debts previously written off partially or whollly.

XIII. Superannuation Funds

26. Have you any suggestions to make on a proposal to place the law relating to Superannuation Funds [Chapter IX (B) of the Income-Tax Act] on a footing similar to that in respect of Provident Funds so as to secure—

(i) that the aggregate of the annual accretion to the Superannuation Fund of an employee including his own contribution but exclusive of interest, together with similar accretions to his recognised Provident Fund, if any, shall not exceed in any year 25 per cent. of his salary proper;

(ii) that the limit for exemption from income-tax as laid down in Section 58(F) shall apply to the aggregate contributions to the approved Superannuation Fund and the recognised Provident Fund of each employee. Similarly, the limit of exemptions on interest as laid down in Section 58 (F) shall apply to the aggregate of the interest on the Provident Fund and the Superannuation Fund;

(iii) that the annual accretion to the Superannuation Fund shall, like the accretion to a recognised Provident Fund, be deemed to have been received by the employee and shall be included in his total income under the head 'Salary' subject to the exemption from Income-tax but not from Super-tax.

XIV. Super-tax

27. Will it not be right to extend the principle underlying section 17, sub-section (2), to super-tax also, as otherwise persons who are members of unregistered firms or associations may escape payment of legitimate super-tax merely

on payment of some super-tax in the name of the firm (*vide* second proviso to section 55)? Section 23 (5) (b) may not prove to be a sufficient safeguard and it has no application to associations.

... **XV. Submission of return**

28. What ways can be devised to compel a man who has been successfully escaping the attentions of the Income-tax authorities to submit a return of his income or to declare by a sworn statement that his income was below the taxable limit? Under the present practice the burden lies on the Income-tax authorities to find out whether a man has taxable income or not before issuing a notice to him under section 22 (2), and in this way many people escape taxation altogether. Failure to make a return in persuance of a general order under section 22 (1) is not an offence under the Income-tax Act.

XVI. Accounts (keeping and production)

29. Is it not time to provide in the statute itself as in Australia and in some other countries that every person carrying on business should keep sufficient records of his income and expenditure to enable his assessable income and allowances to be readily and truly ascertained?

30. What steps can be taken to encourage, if not to compel as large a number of assessees as possible (particularly those engaged in business) to keep proper accounts, to preserve them for at least some years, and in cases where they relate to business fetching an income above a certain limit to adopt the practice of getting them audited by qualified auditors?

31. Do you see any objection to auditors being asked to report to the Income-tax Department at the end of each year the names of the persons or concerns whose accounts they have audited during the year? It has been suggested that the fact of audit is often concealed by some assessees to enable them to conceal from the Income-tax authorities the result of the audit if the audit happends to show large profits.

XVII. Best judgment assessment

32 How do you suggest the Income-tax Officers should proceed where they find that accounts have been suppressed or that the accounts produced are not complete and they are driven to make a best judgment assessment? On what basis should such assessments be made? What in your opinion should be the scope of an appeal against a best judgment assessment?

XVIII. Avoidance and evasion

33. What changes would you make in proviso 1 to section 43 to ensure that a non-resident broker is a genuine broker and not an *alias* for the foreign merchant?

34. In what manner can the provisions of section 16 (I) (c) and sub-section (3) be amplified so as to hit at devices similar in principle but different in form from those specifically mentioned in the section? A question has arisen particularly with reference to transfers in favour of grand-children, nephews, illegitimate children, etc., and also in respect of shares in companies held in or transferred to joint names of husband and wife.

35. Would it not be right to provide that, when the income from the transferred property is assessed as if it were the income in the hands of the transferor, the tax thus assessed shall be recoverable also from the property so transferred?

36. If blank transfers of shares and securities are permitted to continue, what safeguards would you suggest to prevent that practice being utilised to defraud public revenue (1) by concealing the identity of the person who

received dividends or interest, (2) by concealing profits made in share dealings, and (3) by claiming genuine or fictitious losses while concealing profits?

Even if the transfer is not in blank, is it necessary or desirable to make a specific provision in the Act as to the person whom the Income-tax authorities should take note of as the owner of the share during the interval between the date of the transfer and the date of its registration in the books of the company?

37. What measures would you suggest to prevent avoidance of taxation where an employer instead of paying full remuneration as salary pays part of it by giving various benefits such as conveyance allowance, medical allowance, schooling allowance, reduced rent, free food, etc., all these btnefits being not taxable under the law as it stands?

XIX. Persons leaving the country

38. What provisions would you recommend to safeguard against loss of revenue on account of assessees leaving India for good without leaving assets? Would you make any difference in this connection between cases where the person concerned leaves India before completion of assessment and cases where he leaves India after the assessment has been completed but before payment?

XX. Bankruptcy and winding up

39. Will at not be right to enact that the claim for income-tax should have priority over other debts even in liquidation and bankruptcy proceedings? If so, should any difference be made according as liquidation or bankruptcy commences after the assessment of the tax or before assessment?

40 What provision would you recommend to safeguard against loss of revenue on account of a Receiver in bankruptcy or a Liquidator being discharged before assessment or payment or income-tax, payable in respect of income arising during the pendency of the bankruptcy or liquidation proceedings?

XXI. Penalties

41. The provisions relating to the levy of penalties for failure to submit returns are sometimes complained against as leading to arbitrary exercise of power. Can any other scheme be thought of which in the event of failure to submit returns would operate automatically and not at the discretion of the Income-tax Officer? For example, can it be provided that persons who have not submitted their returns shall not be entitled to claim statutory deductions of certain kinds?

42. The penalty provisions of the Income-tax Act as they stand hit only cases where incorrect statement in the return has been deliberately so made. Wil. it not be right to insist on a stricter standard in respect of the liability of assessees to discharge their statutory duty of submitting correct returns?

43. Will it not be right to follow the English law and declare even abetment of submission of incorrect returns to be an offence?

44. What do you think should be the policy of the Government in cases in which it is satisfied that an offence under section 52 or one punishable under I.P. Code has been committed? Should it ordinarily proceed to prosecute the person concerned, or preferably safeguard the revenue by levying a penalty under section 28 or compounding the offence? If the possibility of prosecution is to act as a deterrent. should not the maximum penalty under

section 52 be much greater than it is now? What do you think is likely to be the reaction of the public (1) if there are frequent prosecutions for income-tax offences, and (2) if clear cases of offences are compounded?

45. Have you any comments or suggestions to make with reference to the exercise of the power under section 28 to levy penalties?

XXII. Secrecy and publicity

46. What do you think of the proposal that the provisions of section 54 should be relaxed so as to permit the disclosure of confidential information in the following cases:—

(1) to the Advocate-General, where it appears that there has been a breach of trust relating to charity;

(2) to the Provincial Government, in respect of information having a bearing on the recovery of Sales Tax:

(3) to the proper authorities, when the assessee makes in the course of I. T. proceeding statements which implicate him in a criminal offence and when such statements have been made with a view to escape liability under the Income-tax Act;

(4) to a third person, where the assessee asserts the right of such third person to certain property or income and the Income-tax authorities have reason to believe that such assertion is not true and has been made with a view to escape or reduce liability to tax?

The first three cases are similar in nature to the exemption now recognised under sub-section (3) to section 54 of the Act. The fourth case is similar to the provision contained in section 7 (4) of the Income-tax (Investigation Commission) Act. The possibility of the disclosure being made to a party who may be in a position to take advantage of the false statement made by the assessee may act as a deterrent against the assessees recklessly making such false statements.

47. Have you any suggestions to offer or remarks to make in respect of the following proposals:—

(1) that wide publicity should be given in respect of cases where assessees are, after enquiry, found to have made gross under-statements of their income;

(2) that similar publicity should be given to gross instances of cases in which persons have been convicted of income-tax offences?

XXIII. Appellate procedure

48. Do you think that it is necessary to provide a right of appeal (i) against an order of rectification under section 35, and (ii) against an order of the Appellate Assistant Commissioner refusing to extend the time for filing an appeal on dismissing an appeal as not filed in time?

49. Can a non-resident assessee who fails to pay the demand be put on condition that he should deposit the tax before any appeal filed by him against the assessment is heard? Alternatively, can he not be asked to give security for payment in the event of the decision going against him?

50. Will it not be right to enact in the statute itself that fresh evidence can be admitted in appeal only in cases in which the same could not have been produced before the Income-tax Officer even with due diligence and attention?

What have you to say regarding a proposal that in all appeals under the Act the onus should be specifically laid upon the appelant to show that the Income-tax Officer's assessment order was wrong? This appears to be the rule in England.

51. What course would you suggest to safeguard the interest of revenue in cases in which a person who has become entitled to a refund of the tax levied from him on the reversal of an order of assessment may ultimately be held liable by higher appellate authority, if by that time the person has either left the country or has failed in business and is no longer in a position to pay? The statute, as it now stands, provides for only one possible contingency of this kind, namely, when Government appeal to the Privy Council against an order of the High Court [see proviso to Sub-Section (7) of Section 66].

XXIV. Administration

(a) *Income-tax Officers*

52. What have you to say to a proposal that enhanced powers should be given to Income-tax Officers to enable them to gather relevant information, particularly—

(i) to deal effectively with persons suspected of having black market dealings;

(ii) to enter business premises and inspect the accounts maintained therein, place identification marks thereon and make copies therefrom and if the officer has reason to think that they may not be forthcoming when required, to impound them;

(iii) to make a search of places where there are reasonable grounds for believing that relevant books and records have been kept; and

(iv) to call for relevant information from banks and other business houses.

53. Would it not be desirable to have a provision in the statute itself specifically authorising officers of the Income-tax Department to call upon assessees to submit total wealth statements at any time they may consider it necessary?

54 Have you any suggestions to make—

(i) relating to recruitment and training of Income-tax Officers and distribution of work among them;

(ii) calculated to improve the relations between the public and the income-tax staff; and

(iii) to educate public opinion to the due realisation of civic responsibility in the matter of meeting the tax obligations and co-operating with the Department.

55. Can you suggest any remedies to meet complaints frequently made of unreasonable delays on the part of the Department in dealing with claims for refunds? Do you think that there is any justification for a complaint that the provisions of Section 48 receive unduly narrow interpretation at the hands of the Department? If you think so, how do you suggest that this should be remedied?

(b) *Inspecting Assistant Commissioners*

56. Is it advisable to define in the statute itself the powers and duties of Inspecting Assistant Commissioners and the Director of Inspection in view

of the existing practice of their inspecting assessment records and advising Income-tax Officers in matters connected with current assessments?

(c) *Appellate Assistant Commissioners*

57. What do you think of a proposal to make the following changes in the provisions relating to appeals:

(i) that the Appellate Assistant Commissioners should be removed from the control of the Central Board of Revenue and placed under the control of the Ministry of Law;

(ii) that there should be only one appeal on questions of fact, namely, to the Assistant Commissioner in certain classes of cases and direct from the Income-tax Officer to the Appellate Tribunal in other cases. This would correspond with the practice in the ordinary Civil Judicature.

XXV. Rewards

58. Is it desirable that the Income-tax Department should reward informers for valuable information to the Department in respect of tax evasions? If so, what safeguards would you suggest so that the system may not be availed of by blackmailers?

59. What do you think will be the appropriate procedure to be followed when an assessment proceeding started before one Income-tax Officer has to be completed before another, either because the case is transferred from one Income-tax Officer to another or because one Income-tax Officer is on transfer, retirement, etc., succeeded by another? Can the proceeding be continued from the stage which it has already reached, or do you think it necessary or worthwhile to have a rehearing either in all cases, or at any rate in cases in which the assessee so desires?

XXVI. General

60. Have you any other suggestions to make, on points not covered by the above questions, by way of amendment of the Income-tax Act or with reference to its administration, especially with regard to avoidance or evasion of the payment of Income-tax?

List of Chambers of Commerce, individuals etc. who sent in replies to the Questionnaire issued by the Commission.

1. A. F. Ferguson & Co., Bombay.
2. Accountants' Library, Calcutta.
3. Africa & Overseas Merchants' Chamber, Bombay.
4. Agrawala, Dr., M. N., Allahabad.
5. Ahmedabad Millowners' Association, Ahmedabad.
6. Aiyar, Mr. P. N. S., B.A., G.D.A., Madras.
7. Aiyar, Mr. S. V. & Co., Registered Accountants, Delhi.
8. Aiyer, Mr. R. N. Rajam, Registered Accountant, Madras.
9. All India Exporters' Association, Bombay.
10. Andrew Yule & Co., Ltd., Calcutta.
11. Bajaj, L. Kirparam, Advocate, Delhi.
12. Bar Association, Ahmedabad.
13. Bengal Chamber of Commerce, Calcutta.
14. Bengal National Chamber of Commerce, Calcutta.
15. Berar Chamber of Commerce, Akola.
16. Bombay Piece-Goods Native Merchants' Association, Bombay.
17. Bombay Shroffs (Bankers) Association Ltd., Bombay.
18. Burmah-Shell, Bombay.
19. C. C. Chokshi & Co., Bombay.
20. Chamber of Commerce, Bombay.
21. Chettiar, Mr. A. Ramalingam, B.A., B.L., Member, Indian Constituent Assembly, Coimbatore.
22. Dalal & Shah, Registered Accountants, Bombay.
23. Dalal, Desai & Kumana, M/s., Bombay.
24. Dalal, Mr. R. P., Member, Income-tax Appellate Tribunal, Bombay.
25. Federation of Indian Chambers of Commerce & Industry, New Delhi.
26. Federation of Woollen Manufacturers in India, Ahmedabad.
27. Fordwood, Mr. D., C.A., Calcutta.
28. Fraser & Ross, Registered Accountants, Madras.
29. G. M. Oka & Co., Registered Accountants, Poona.
30. G. P. Kapadia & Co., Registered Accountants, Bombay.
31. Government of Assam.
32. Government of C.P. & Berar.
33. Government of Madras.
34. Government of Orissa.
35. Government of West Bengal.
36. Gupta, Mr. S. M., Judicial Member, Income-tax Appellate Tribunal, Calcutta Bench.
37. Gupta, R. B. Krishnalal, Lieut., B.A., LL.B., Advocate, Federal Court of India & Allahabad High Court, Kanpur.
38. Harries, Mr. Justice Trevor, Chief Justice, Calcutta High Court.

39. Hindustan Chamber of Commerce, Madras.
40. Income-tax Bar Association, Benares.
41. Income-tax Gazette, Delhi.
42. Income-tax Practitioners' Association, Ahmedabad.
43. Indian Chamber of Commerce, Calcutta.
44. Indian Chamber of Commerce, Tuticorin.
45. Indian Merchants' Chamber, Bombay.
46. Iyangar, Mr. R. Srinivasa, Asst. Commissioner of Income-tax (Retd.) Bombay.
47. Iyengar, Mr. A. C. S.
48. Iyer, Mr. C. Krishnaswami, Advocate, Madras.
49. Jamuar, Mr. B. P., Barrister-at-law, Registrar, High Court, Patna.
50. Karnatak Chamber of Commerce, Hubli.
51. Khanna, Mr. Lalchand, Delhi.
52. M. S. Krishnaswami & Jagannathan, 5, Sambasivan St., Madras.
53. Mahakoshal Chamber of Commerce, converted and re-registered as Chamber of Commerce, Jubbulpore.
54. Malhoutra Mr. P. C., Member, Income-tax Appellate Tribunal, Bombay.
55. Manoharlal, Mr. Justice.
56. Manu Subedar, Mr., Kodak House, Bombay.
57. Marwari Chamber of Commerce Ltd., Bombay.
58. Merchants' Chamber of U.P., Kanpur.
59. Millowners' Association, Bombay.
60. Motion Picture Society of India, Bombay.
61. Mukerjee, Mr. S. N., C/o T.A. Martin & Co., Calcutta.
62. Muslim Chamber of Commerce, Calcutta.
63. Nagindas & Manoklal, Bombay.
64. Narandas M. Shah & R. N. Mehta etc., Registered Accountants, Bombay.
65. Native Share Brokers' Association, Bombay.
66. Nausher Mr. Marfatia & Co., Auditors, Ahmedabad.
67. Parthasarathi, Mr. P., Registered Accountant, Berhanpur.
68. Payne & Co., Solicitors, Bombay.
69. Price, Waterhouse Peat & Co., Calcutta.
70. Punjab Chamber of Commerce, New Delhi.
71. Raghavan, Mr. A. N. S., G.D.A., Registered Accountant, Madras.
72. Ramanlal G. Shah & Co., Auditors, Ahmedabad.
73. Mama Rao, Mr. C. S., Special Counsel, Income-tax Madras.
74. S. S. Mataldinni & Co., Public Accountants and Income-tax Practitioners, Hubli.
75. Sachdevji, Mr. A. R., Appellate Assistant Commissioner, Meerut.
76. Saigal, Mr. P. N., President, Income-tax Bar Association, Benares.
77. Sankara Narayana, Mr. B. C., Puri.
78. Shah, Mr. A. N., I.C.S., President, Income-tax Appellate Tribunal, Bombay.
79. Shah, Mr. B. C., Bombay.
80. Shah, Mr. Chimanlal C., Rajpipla.

81. Shah, Mr. Lalbhai Chimanlal, Pleader, Ahmedabad.
82. Sharifuddin, P., Khan Bahadur, Distt. Judge, Vizagapatam.
83. Sharp & Tannan, Chartered Accountants, Bombay.
84. Sital Prasad, Lala, Kanpur.
85. Society of Auditors, Madras.
86. Society of Chartered Accountants in India & Burma, Calcutta.
87. Southern India Millowners' Association, Coimbatore.
88. Sundaram, Mr. V. S., Delhi.
89. The Tamil Chamber of Commerce, Madras.
90. Upper India Chamber of Commerce, Kanpur.
91. Vachha, K. B., J.B., Bombay.
92. Vaish, Mr. S., Auditor, Kanpur.